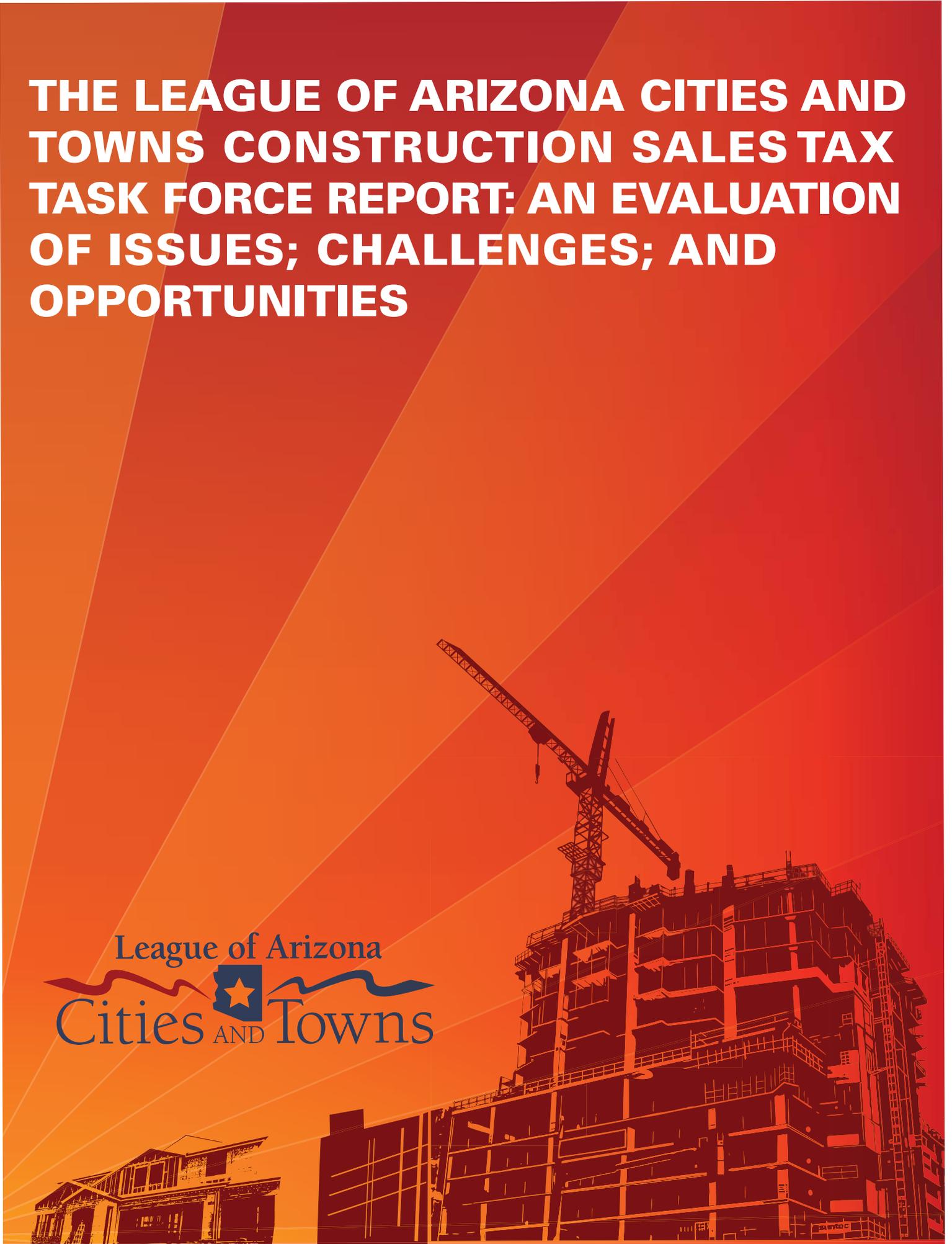


THE LEAGUE OF ARIZONA CITIES AND TOWNS CONSTRUCTION SALES TAX TASK FORCE REPORT: AN EVALUATION OF ISSUES; CHALLENGES; AND OPPORTUNITIES



**THE LEAGUE OF ARIZONA CITIES AND TOWNS
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The Honorable Jay Tibshraeny, President
League of Arizona Cities and Towns

Dear President Tibshraeny and Members of the Executive Committee,

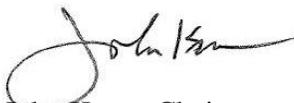
Over the last year and a half I have had the honor of working closely with fellow municipal professionals to carefully consider the state's construction sales tax system and possible reform options as part of the Construction Sales Tax (CST) Task Force. It has been quite an undertaking. We spent hours reviewing the history of the construction tax structure, evaluating numerous comparative states' systems, commissioning the work of consultants, soliciting input from key stakeholders and analyzing options for possible reform. Our goal was to conduct a comprehensive and exhaustive review of the system, including the impacts to the state and industry. An important assignment in this overall effort was to also raise the awareness of the implications of change to major tax policy within the state.

After careful and thoughtful deliberations and weighing of stakeholder concerns, we established six key principles to guide our evaluation of options. The Task Force feels these principles are critical to our local economies, assure fairness to all stakeholders, and provide stability for local and state government's delivery of services. The CST Task Force evaluated seventeen different options. But, only three options are offered for further legislative consideration, primarily addressing challenges with a majority of the contractors that are operating in the maintenance, repair, remodel and alteration category. However, another option is provided that addresses a more substantive change to the entire system. The Task Force acknowledges this proposal will require a more thorough analysis by individual communities in order to fully understand its implications. Again, in all options considered, the established principles provided the overarching guidance for our conclusions.

The importance of the health of our transaction privilege tax (TPT) systems cannot be overstated. TPT is the lifeblood of how cities and towns across the state pay for the critical community services they provide. Oftentimes, construction activity accounts for a significant portion of a city or town's revenues – particularly in growing municipalities such as Queen Creek, among many others. TPT revenues are already vulnerable to volatility which would be exacerbated by changes to construction sales tax system.

On behalf of the CST Task Force, we are thankful to the Executive Committee for the opportunity to work on this important economic issue. Our hope is that this research will assist legislators in analyzing possible reforms and prompt careful consideration of their impacts to local communities, the state, and our industry partners.

Respectfully Submitted,



John Kross, Chair
Town Manager
Town of Queen Creek

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EXECUTIVE SUMMARY

Transaction Privilege Tax (TPT) is one of the most important sources of revenue for the state and local governments. These revenues account for as much as half of general operating funds for cities and towns. Within this category, construction contracting activity is one of the more significant revenue generating activities.

For decades, there have been numerous attempts to eliminate the contracting tax and to replace it with a system that taxes only the materials used in a construction project. In an effort to create credible information about the impacts of moving to a “materials-only” system for contracting and to work towards identifying an alternative to our existing construction sales tax system, the League of Arizona Cities and Towns (League) Executive Committee requested a task force be formed to analyze this policy proposal and to attempt to calculate its fiscal impact. This report is the result of the work that task force.

Over the years, three main arguments had emerged for a “materials-only” tax. These were: imposing tax on materials at the retailer would be simpler than our existing contracting tax system; some other states only tax materials; and, the misuse of exemption certificates under our current system is so widespread that moving the imposition of the tax to the retail transaction would make up any revenue loss through a higher degree of compliance.

The analysis of other states did show that most of them do tax materials used in construction. However, other states imposed additional taxes on contracting activity, such as a real estate transfer tax, or they had other sources of revenue available to them that have been rejected by Arizona policy makers.

Additionally, the CST Task Force’s research found that only Utah taxes materials when they are purchased at the retail location. The other states imposed the tax at the job site so that the revenues were available to the jurisdiction in which the construction activity was occurring.

The League commissioned a study to determine the revenue loss due to the misuse of exemption certificates. While the data does not exist that would allow the value of noncompliance to be precisely calculated, the study did conclude that, while the rate of noncompliance may be high, the fiscal impact of the tax leakage is relatively small. Based on this analysis, it is extremely unlikely that capturing this small amount of revenue would make up the significant loss of moving from our existing contracting tax system to one that taxes only materials.

The CST Task Force sought to quantify the financial cost of shifting to a “materials-only” tax policy for construction activity. The members developed a model to test the fiscal impact of the various contracting tax proposals that have been made. This analysis concluded that eliminating the contracting tax and imposing a retail tax on materials--only would reduce state revenues by approximately \$150 million annually. While all cities and towns would lose revenue under this tax proposal, the actual fiscal impact on individual cities and towns varies and is much harder to calculate as it greatly depends on the mix of construction activity that is occurring within a jurisdiction.

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The CST Task Force also analyzed the reasons for the complexity of the existing system. A principal reason is the series of approximately ten exemptions and 20 deductions that have been enacted by the legislature. Currently these exemptions and deductions are subtracted from the gross proceeds of a construction project before the state and local tax is even applied. These exceptions create audit risk and often lead to litigation to determine tax liability. It is politically unlikely that these exemptions will be eliminated, but any tax system that includes these exceptions will not achieve simplicity.

Another issue that has been raised repeatedly as a source of complexity for taxpayers was the 2013 change that created the category of Maintenance, Repair, Replacement and Alteration (MRRA). This statutory change moved a portion of contracting jobs in these categories to a “materials-only” tax. While it was well-intentioned, this policy needs to be modified to create more clarity. The CST Task Force reviewed two concepts that could potentially help resolve this issue. Each of these would create a more clear delineation between when a project qualifies for the “materials-only” tax and when construction sales tax would need to be imposed.

The CST Task Force also analyzed a concept that has been proposed using a materials tax plus an excise tax. More analysis would need to be done to make this model revenue neutral and there would continue to be substantial challenges in ensuring local revenues were received in the locations in which the construction activity is occurring. Additionally, if all the existing exemptions and deductions were simply recreated in a new system, it is unlikely that any simplification would be achieved.

Based on its evaluation and analysis the CST Task Force concludes the following:

- The state and local governments will experience a significant loss of revenue if the contracting tax is eliminated and replaced with a tax only on construction materials. Furthermore, no other Arizona TPT is imposed only on component materials.
- Much of the complexity that plagues the current contracting tax system is related to the many statutory exemptions and deductions allowed.
- The creation of the Maintenance, Repair, Replacement and Alteration (MRRA) tax system has created more complexity for taxpayers and should be modified to improve compliance and simplify the system.
- Use tax should be made uniform across all jurisdictions with the state, county and local Use tax rates set at the same rate as Retail in each jurisdiction.
- The legislature should avoid undermining the principles of the state’s existing transaction privilege tax system by making sweeping changes to our tax code for the benefit of one industry.

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PROJECT OVERVIEW

Arizona relies heavily on transaction privilege taxes (TPT) as a key source of revenue for state and local governments, in many cases comprising as much as half of their general operating funds. TPT is similar to the sales taxes imposed in most states, except it is imposed on the seller based on their gross receipts from selected business activities. One of the more significant revenue generating activities included within this category of taxation is construction contracting. In fiscal year 2015/2016, this classification generated more than \$384 million to the state general fund, \$96 million to the shared revenue distribution base, and more than \$200 million in direct city and town revenues.

Although there are key differences between TPT and sales tax, these terms are often used interchangeably in discussion, and therefore, also in this report. Similarly, there are differences between the state and local Contracting classifications. However, unless one classification or another is specifically identified, any reference to the “Contracting classification” or “Contracting tax” refers to both the state’s “Prime Contracting” classification and the Model City Tax Code Construction Contracting classifications.

Taxes generated from construction activity have been the subject of much debate and discussion at the Arizona State Legislature and there have been several attempts over the years to modify this portion of our tax system. In 2012, then-Governor Jan Brewer established a Transaction Privilege Tax Simplification Task Force, which recommended a number of changes to the system – including eliminating the Contracting classifications at the state and local levels and shifting to a model that only taxes materials used in a construction project. This shift would be a departure from Arizona’s current tax system that imposes TPT on the gross receipts of the business activity of all tax classifications, including contracting. That task force asserted the recognized revenue loss from this change would largely be recovered through reduced noncompliance accomplished by transferring the tax burden to retail sellers of construction materials.

Although this idea did not fully make it into the final TPT Simplification bill that was passed in 2013 (HB 2111, 51st Legislature, First Regular Session), the legislation did create a bifurcated system designed to address the concerns of contractors performing repair and maintenance activity. The existing tax system remained in place for contractors performing new construction and major modifications while most repair and maintenance activity would be taxed only on the materials used in the construction project. When these changes took effect in 2015, the new rules resulted in some contractors being responsible for the payment of taxes under both systems depending on the type of construction project they were engaged in. This prompted a renewed interest in an almost complete elimination of the Contracting classifications, and in the 2016 legislative session this idea was proposed again (HB 2267, 52nd Legislature, Second Regular Session) but did not move forward.

During the 2017 legislative session HB 2521 was introduced and again included the elimination of Contracting and a pooling of city Retail taxes for redistribution based on building permits. This bill progressed further through the process, resulting in the Joint Legislative Budget Committee

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(JLBC) producing a fiscal note on its proposed impact which indicated a loss to the state general fund of \$141 million per year.

In response to these continued reform efforts, the League of Arizona Cities and Towns (League) Executive Committee instructed staff to oppose the 2016 legislation because the fiscal impacts were unknown, and directed them to form a new task force to review the issue and develop information that would be helpful in the policy discussions on this topic.

In June of 2016, the League's Construction Sales Tax Task Force (CST Task Force) began its work with a focus on analyzing the key arguments made by the proponents of a "materials-only, point-of-purchase" tax to determine their validity; examining the various legislative proposals introduced over the years to assess their fiscal impacts on state and local revenues; and developing and analyzing alternative plans to see if one might be acceptable to the various stakeholders. The CST Task Force was open to the public and included a diverse group of professionals from local government. They met from June 2016 to October 2017 and will continue to meet as necessary to review and analyze any new proposals.

BACKGROUND

Taxing construction activity has been part of Arizona's tax system since the 1930s. In 1978, legislation established the framework for the construction contracting tax system that was in place through 2014. This legislation clarified two major elements: responsibility for the tax falls on the prime contractor and 35 percent of the gross income or gross proceeds of sales from contracting activity (after all other deductions and exemptions have been taken) would be allowed as a standard deduction for labor costs, with the remaining 65 percent of the gross proceeds being subject to tax. Prior to negotiating this standard deduction, companies were required to separately identify their direct labor costs in order to deduct them. This resulted in many years of audit controversy over which labor costs were actually "direct" and thus exempt versus which labor costs were not deductible. The 35 percent standard deduction was an agreed upon percentage negotiated among the stakeholders at that time.

The 35 percent standard deduction is applied to the gross income of a construction project after all other deductions have been taken. Tax is then imposed on the remaining 65 percent of income. This 65 percent was never intended to only represent a tax on materials. The standard deduction was simply a convenient way to allow an exemption for direct labor costs without controversy or audit risk. In this way, taxing 65 percent of a contract's value is equivalent to taxing the gross of any other activity after deductions. No other taxable activity in Arizona is taxed only on its cost of materials.

Over the intervening years there have been numerous legislative proposals that would shift from a Contracting tax to a Retail tax imposed only on the cost of construction materials. Proponents often refer to this change as a "point-of-sale" tax, meaning taxes are imposed on the vendor's retail sale of the materials to the construction contractor. However, it is more accurate to refer to this type of transaction as "point-of-purchase" while "point-of-sale" refers to when the materials are incorporated into a construction project at the job site and ultimately sold to the end user.

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Most notable was the introduction of SB 1206 (sales tax; contracting) in 1995. There was extensive testimony stating this bill would significantly reduce revenues to the state and to local governments. But, proponents argued that since construction materials were exempt from retail taxation, there was a high incidence of misuse of exemption certificates by contractors resulting in a high level of noncompliance and tax revenue leakage. They argued moving the incidence of the tax to the retail transaction on materials would increase compliance and any losses in revenue from the elimination of the tax on construction contracting would be recovered.

The bill passed and was subsequently sent to then-Governor Fife Symington. Governor Symington vetoed SB 1206 because both the Arizona Department of Revenue (ADOR) and the Joint Legislative Budget Committee (JLBC) had independently projected a potential revenue loss in excess of \$50 million to the state and an additional \$20 million loss to cities and towns. In his veto message (attached as Appendix 14), Governor Symington cited the lack of reliable information related to the true financial impact of noncompliance, as well as the actual percentage that material costs represent in the gross income from construction contracting. He also stated that, given the public policy agenda he wished to pursue of eliminating the income tax, the potential revenue loss outweighed the potential simplification.

The issue of noncompliance has remained a primary argument for proponents of taxing materials only at the retail vendor's location. In 1999, the Arizona Tax Research Association (ATRA) commissioned a study by Arthur Andersen titled, "*Analysis of the State Revenue Impact of Shifting the Incidence of the State Transaction Privilege Tax from Prime Contracting to Materials*" (Appendix 13) in an effort to calculate the level of revenue leakage due to noncompliance. Based on the methodology used in this study, it reported that as much as 43 percent of the taxes owed on construction activity were not being remitted and concluded that moving to a tax on materials at the point of purchase would significantly increase compliance. It further concluded that this shift in tax policy would increase state revenues by approximately \$50 million.

This report has been widely cited in subsequent discussions on construction contracting taxation and has been used as a key argument for moving to taxing materials when they are sold to contractors rather than taxing the gross income from the activity of construction contracting. Because of its significant influence on the debate, an analysis of this study was commissioned by the League as part of its CST Task Force's work effort (Pollack Study, Appendix 12). The details of this analysis are included in the section below related to noncompliance.

In 2012, then-Governor Jan Brewer established the Transaction Privilege Tax Simplification Task Force (Simplification Task Force). The focus of that task force was: to study simplifying collection of TPT and the performance of audits; to examine the Retail classification and recommend changes necessary to take advantage of any future federal legislation (e.g., Marketplace Fairness Act) that would allow for taxation of remote sales; and, to review the Contracting classification.

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At that time 18 cities, including most of the largest municipalities, collected their own transaction privilege taxes and performed their own audits. The Simplification Task Force recommended centralizing collection of all TPT with the Arizona Department of Revenue, and requiring all audits to be performed in a uniform manner for all jurisdictions by auditors trained and certified by the ADOR. These policy changes were subsequently included in HB 2111 and enacted. The new audit provisions were implemented in January 2015, and centralized collection and administration began with the January 2017 reporting period.

In reviewing remote sales and the Retail classification, the Simplification Task Force recommended bringing the state and local tax bases and exemptions into conformity as much as possible. The Model City Tax Code (MCTC) was significantly amended to eliminate many differences. The TPT Simplification bill passed into law also included an elimination of one state-level exemption for sales to non-residents to match the MCTC. (Note: This exemption was subsequently reinstated in part by the legislature, reviving the exemption for remote sales of fine art by an auction house.)

The Simplification Task Force also recommended that counties be allowed to impose Use tax and that the state's Use tax should be included in the revenue sharing pool since the Use tax is simply the mirror of the Retail classification. Influencing this recommendation was the ADOR statement that the Marketplace Fairness Act would result in remote sales over the Internet being taxed under the Use tax statutes, so equity for in-state vendors demanded that Use tax be imposed uniformly to match Retail, including the distribution of shared TPT revenue. Ultimately, this item was not included in the TPT Simplification bill that was signed into law.

With regard to construction contracting, many presentations were given and discussions of various concerns about construction sales taxes were raised. The Simplification Task Force recommended the elimination of the Contracting classification in favor of a "materials-only, point-of-purchase" tax collected by the vendor, pointing to the effect of assumed noncompliance in its analysis. For purposes of measuring the fiscal impact of the original draft of legislation, the ADOR again looked to the 1999 Andersen study's proposed noncompliance rate of 43 percent. Although the department did not explain its methodology, it eventually used a 31 percent noncompliance rate for calculating the fiscal impact on the state and local governments. Complete elimination of the Contracting classification was eventually removed from the final bill after resistance by municipalities due to the uncertainty of the many assumptions used in the analysis of the legislation and the associated risks to state and local government finances.

At the same time, much focus was placed on the existing tax system's perceived unfairness to the repair segment of the Contracting classification (for example, plumbers and handymen). The issues raised included that repair contractors often did not know which local jurisdiction they were working in, and therefore, which tax rate to apply. Additionally, they stated it was burdensome to file one tax return with the state and separate tax returns for those cities that administered their own taxes. They also stated that the 35 percent standard deduction did not accurately reflect their true labor costs since these costs are typically much higher relative to the total contract price than for other types of construction activity.

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In response to these concerns, included in HB 2111 was an initial effort to separate most small repair and remodel contractors from the rest of the Contracting classification, allowing them to shift their tax method to a materials-only model. Additionally, as part of the resulting TPT Simplification project initiated under HB 2111, the ADOR added address-specific Geographic Information System (GIS) capability to its website so contractors can easily identify which city they are working in and exactly which tax rates to apply. Also, beginning in January 2017 all taxpayers now file one tax return with the ADOR that includes the state, counties, and all 91 municipal jurisdictions.

Subsequent changes to the 2013 legislation (HB 2389 in 2014 and SB 1446 in 2015) further attempted to define the break point between a small contractor and larger construction activity. These changes ultimately resulted in the Maintenance, Repair, Replacement and Alteration (MRRA) system that exists today. This system allows contractors engaging in certain limited construction jobs to pay Retail tax to the vendor on materials used in that job, while the larger construction projects remained taxable under Prime Contracting, based on 65% of the total contract price.

However, the complexity of this system has led to inconsistent application as reported by the contractors themselves; particularly about when to apply the MRRA tax on materials-only at the point of purchase or when a project is subject to the Prime Contracting tax. This confusion over the new MRRA system prompted some policy makers and industry representatives to continue to advocate for more change to the Contracting tax system.

During the 2016 session, legislation was again introduced that would largely eliminate the Contracting tax based on the gross income of the activity and replace it with a tax imposed exclusively on the retail price of materials to be collected by the vendor (HB 2267). In an effort to mitigate the negative revenue impact on local jurisdictions, the bill included an additional 2% state tax on all construction materials, which would be distributed to cities and towns based on the value of building permits issued by a city or town as a percentage of all building permits issued statewide.

While this bill did try to address the obvious reduction in revenues to local jurisdictions, the actual revenue impact had not been determined so it was unclear whether 2% would meaningfully offset the loss of revenue to local jurisdictions. The proposal also did not address any revenue losses by the state or counties.

Additionally, there were many concerns raised with the idea of using building permit values as an accurate measure of construction activity. Concerns included:

- Permits are not required for many construction projects;
- The permitting process is not uniform across jurisdictions;
- Valuation tables used for permitting varies from jurisdiction to jurisdiction;
- Permit issuance does not reflect actual construction activity occurring in any specific period;
- Permits often do not include changes in value due to change orders;
- Issuance of a permit does not always result in a completed construction project.

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During the 2017 session, legislation was again introduced (HB 2521). Similar to the HB 2267 from 2016, this version would eliminate the Contracting classifications and replace it with a tax imposed exclusively on the contractor's purchase price of materials to be collected by the various materials vendors. This bill dropped did not include the additional 2% state tax on all construction materials, and instead added a proposal for all cities and towns to donate a portion (4%) of all their Retail taxes collected into a pool, which would be distributed back to the cities and towns based on the value of building permits issued by each municipality as a percentage of all building permits issued statewide.

This bill had several challenging aspects. First, by having cities redistribute their local Retail tax without adding any new revenues, there was little chance this idea would effectively keep the cities and towns revenue neutral. For example, a city with higher *value* permits may receive revenues from another city that actually had a higher *quantity* of actual permits, negatively impacting the city with the higher growth curve. Additionally, the same flawed building permit mechanism for distribution was still in place. There was significant concern about including all Retail TPT since many sales have absolutely no connection with construction activity. Finally, this proposal did not address any revenue losses by the state or counties. Later a new 1% excise tax was suggested to close the state and county gap, but this idea never made it into an adopted amendment. HB 2521 did manage to move further through the process and the Joint Legislative Budget Committee provided a fiscal analysis of the bill (Appendix 15) that concluded the state general fund would lose approximately \$141 million dollars per year under the new plan.

LEAGUE CONSTRUCTION SALES TAX TASK FORCE MEETINGS AND DISCUSSIONS

In June 2016 the League formed the Construction Sales Tax Task Force (CST Task Force) made up of 16 representatives from a mix of urban and rural communities. The members included city managers, intergovernmental affairs staff, city finance managers and tax audit staff. It was chaired by John Kross, Town Manager for the Town of Queen Creek. A list of the task force members is attached as Appendix 1.

The CST Task Force met throughout the summer and fall of 2016. They reconvened in July 2017 to continue their analyses of new concepts that were proposed during and after the 2017 legislative session. The CST Task Force first worked to identify the concerns of the various stakeholder groups, included as Appendix 2. Next, the group developed a list of principles the members believed should be used to guide any change in tax policy. The *Principles of a Construction Activity Transaction Privilege Tax and Use Tax System* is attached as Appendix 3.

The CST Task Force then reviewed the history of contracting taxes in Arizona to gain an understanding of the evolution of our state's tax policy as it relates to contracting (see History of Construction Contracting presentation, Appendix 4). The CST Task Force also compared Arizona's tax policy to that of nine other states (a mix of neighboring states and others identified as TPT states). This research was important because the proponents of a "materials-only, point-of-purchase" system often cite other states' tax policies as a reason to change Arizona's

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system. An analysis of these other states' tax systems will be discussed in more detail later in this report.

Another important issue the CST Task Force closely examined was noncompliance. Proponents of shifting the tax to the vendor where materials are purchased rely heavily on the 1999 Andersen study and its assumption of potential revenue losses due to noncompliance. The CST Task Force investigated this problem, largely based on an analysis conducted by Elliott Pollack & Company.

Throughout the process CST Task Force members were invited to submit concepts for changes to the current Contracting tax system. A listing of all the proposed concepts is attached as Appendix 6. Three concepts that met all of the principles except revenue neutrality (no proposal fully ensured that principle) were analyzed by the CST Task Force and are discussed further below. A summary of the examined concepts is attached in Appendix 7.

PRINCIPLES OF A CONSTRUCTION ACTIVITY TRANSACTION PRIVILEGE TAX AND USE TAX SYSTEM

The purpose of imposing TPT is to collect sufficient revenues to provide those services and programs needed by a city or town's residents and local business interests. Thus, an overarching policy of the entire TPT system is that tax revenues should be available to the jurisdiction where the activity and its impacts occur.

As it relates specifically to Contracting tax, Arizona has a long-standing tradition, arguably culminating with the 1998 Growing Smarter Act, of articulating the policy that development activity should pay its proportionate share of the needs it creates on the jurisdiction where growth and development activity is occurring.

In addition to having the necessary revenues to provide the services residents and local businesses require, municipalities also have other important considerations. These include: the integrity of the TPT system as a whole; effects on other related policies and financial considerations such as revenue bonding and the calculation of impact fees; ease of compliance; and fairness among similarly situated taxpayers.

The CST Task Force identified the following set of principles that should be considered in the development of any Contracting tax system:

- ***Ensures tax revenues are remitted to the jurisdiction in which the activity occurs***
- ***Does not result in a significant reduction in revenues for the state or local governments***
- ***Maintains the integrity of other tax systems and policies***
- ***Provides fairness for all similarly situated taxpayers***
- ***Easy to determine tax obligation and to comply with remittance***
- ***Prevents tax avoidance by relocating or restructuring businesses***

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These principles were used by the CST Task Force to evaluate proposals brought forward by the members and reflect the concerns from taxpayers, the state, municipalities, counties, and the industry. Some proposals were ultimately rejected because they violated one or more of these principles. The only principle that could not be met under any of the new concepts was fully maintaining revenues. However, the members of the CST Task Force were willing to review options that resulted in changes in revenue provided these modifications to the construction contracting tax system would meet the intent of the other principles. More importantly, cities and towns are hopeful that any resulting agreed-upon changes will finally put this issue to rest allowing for stability and certainty for long-term financial planning of services, programs and projects.

COMPARISON OF OTHER STATES' CONSTRUCTION SALES TAX SYSTEMS

One repeated argument for moving to a “materials-only, point-of-purchase” system has been that many other states use this method to tax construction activity.

The CST Task Force reviewed the tax systems used by all neighboring states as well as other TPT states. In total nine states were evaluated. This examination revealed that many of these states do in fact apply tax based on the materials in one form or another. However, all but one imposed the tax on the contractor based on the job site where the materials are used or incorporated into a project (point-of-sale). Additionally, many of those states had access to other methods of raising revenues that fell on the contractor, including real estate transfer taxes; inventory-based property taxes; or local income taxes. Of all the states examined, only Utah imposes tax at the retail location where the actual purchase of the materials occurs, however, it also imposes a significant fee on real estate transfers.

While applying the tax at the job site is not as simple for the construction industry as paying the tax on materials at the time they are purchased at the retail location and does not eliminate the use of exemption certificates, it does alleviate the issue of municipalities receiving tax revenues at the location of the construction activity and, therefore, where the impact of that activity occurs. It also eliminates concerns the CST Task Force had with out-of-state purchases and with companies changing their business practices in ways that could help them avoid paying the tax altogether simply through relocation or reorganization.

While many other states' tax systems have evolved around taxing only materials, looking at a single element of a system does not provide a full understanding of how total revenues are derived. All states' tax systems, including Arizona's, are made up of many components. These have evolved based on the unique events which have influenced the specific legislative and administrative changes that ultimately shape their individual tax structures. Many other states also generate revenues to pay for the cost of growth from sources that are unavailable in Arizona or that have been previously rejected by Arizona policy makers (e.g. real estate transfer taxes, a higher reliance on property taxes, or local income taxes).

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ANALYSIS OF NONCOMPLIANCE

Noncompliance is also an issue frequently cited as the reason to change to a construction sales tax system that taxes only materials. The premise is that contractors are misusing their tax exemption certificates to purchase construction materials, and then using these materials in projects without paying contracting taxes. Advocates of a materials-only tax argue if the imposition of the tax were at the point when the materials were purchased at the retail location, there would be less likelihood of tax avoidance.

As mentioned earlier, the 1999 study by Arthur Andersen titled *“Analysis of the State Revenue Impact of Shifting the Incidence of the State Transaction Privilege Tax from Prime Contracting to Material”* (Appendix 13) concluded that the noncompliance rate could be as high as 43% and that, if the tax were imposed on materials at the point of the retail sale, rather than on the gross receipts of the construction project, the state would actually see an increase in the tax revenues generated by construction activity.

This study also provided information related to the percentage of a project that is based on material costs. It concluded that this percentage varies widely depending on the type of construction activity. Looking at underlying data, materials could account for as little as 9% for some road projects, up to as much as 40% of a high-end custom home.

The Andersen study advances the idea that if the misuse of exemption certificates were curbed, the difference between the amount of revenues collected under the current system and the amount collected on only materials would be closed. Municipalities have long questioned the results of this study. The evidence they have seen in collecting TPT on construction activity does not support this conclusion. While it is possible there is noncompliance by a high number of the smaller taxpayers, the experience at the local level does not demonstrate that this translates into a significant amount of revenue. That is, these small taxpayers are not generating the level of business activity and the amount of tax revenues that would be necessary to make up the loss in tax revenues the Andersen study argues.

In an effort to determine the validity of the Andersen study, the League retained Elliott Pollack & Company to review the study’s methodology and conclusions. The Pollack report states the methodology used in the Andersen study significantly overstated the potential value of noncompliance. Several critical flaws were identified including an extensive overestimation of revenues generated by “non-employer businesses” – small construction companies that do not report any employees.

In the Andersen study, these businesses were assumed to generate the same amount of revenues per company as larger construction companies. This assumption was made in spite of the data supplied by the U.S. Census Bureau that shows the largest construction entities, making up approximately 17 percent of the total of all construction companies, paid about 88 percent of the total contracting tax collected.

Additionally, the Andersen study overestimated the revenues generated by contractors registered with the Registrar of Contractors who did not have a TPT license. While a variety of

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reasons could explain this discrepancy (for example, no longer in business, changes in business entity name, etc.) the Andersen study assumes that all these contractors are active but not remitting any contracting taxes.

Finally, the Andersen study did not account for any of the differences between how homebuilders and developers of new construction likely report their revenues to the U.S. Census Bureau versus how they report these to the ADOR. Almost all homebuilders and developers operating in Arizona employ the “Contracting Arm/Marketing Arm” strategy. Under this method, state tax is based on construction cost plus a mark-up, normally 5 percent, reported by the designated “Contracting Arm” entity. Local tax however is based on the actual selling price of the new construction which is reported by the “Marketing Arm” of the builder. When the Census Bureau surveys these companies regarding their total sales for the year, it is far more likely they are reporting the company’s actual gross receipts based on the selling prices of all projects, rather than the limited construction cost plus markup values created solely for tax planning purposes that are reported to the ADOR.

While all of these erroneous assumptions taken together suggest the value of noncompliance is significantly overstated in the Andersen study, determining the real value of noncompliance in terms of revenue is extremely difficult. Since the data is unavailable, turning to past audit information and the experience of the previously self-collecting cities provides some insight.

As noted in the Pollack study, a very high percentage of the tax revenues come from a small number of large construction companies. Their projects are typically larger and highly visible in the community in which they are being built. City staff has access to specific details about these projects through the land use process. Anecdotes about entire homes or commercial projects being built without being taxed are unsupported. Any such activity would require building permits and inspections, attachment to water and sewer systems, addition to the County Assessor’s tax rolls, and recording of title transfer with the County Recorder. All of these events are public information readily available and regularly examined by local tax auditors making it unlikely that such activity escapes notice for any period of time. Additionally, these large, more sophisticated companies have the resources available to ensure tax compliance. Aggregated audit information from the former self-collecting cities shows a high degree of tax compliance among these taxpayers, resulting in little leakage of tax revenue.

Experience in these self-collecting cities has also shown that small construction companies may have a higher incidence of noncompliance, but only a small amount of revenue has been generated from compliance efforts undertaken by these municipalities.

In order to conceptualize the level of noncompliance envisioned in either the Andersen study or used by the 2013 Simplification Task Force, every year the state and cities would have to be missing tax revenues equivalent to missing the construction of a multi-billion dollar project like an Intel plant or thousands of new home sales through the misuse of exemption certificates. Some materials are being purchased exempt from tax by contractors that subsequently do not report and pay as required. However, the likelihood that this illegal activity results in a level of revenue loss that exceeds the total of all taxes paid by several of the largest home builders

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combined is inconceivable. Further, failure to identify, investigate and mitigate losses of the magnitude described in the Andersen study would be a gross dereliction of duty by both city tax auditors and the ADOR.

OPTIONS SELECTED FOR FURTHER ANALYSIS

Seventeen concepts were developed and examined by the CST Task Force. Three concepts met five of the six principles and were analyzed further. These three concepts are referred to here as Dollar Limited, Percentage Limited, and the Arizona Contracting Excise Tax (ACET).

To compare the impacts of these various plans on local governments, a common set of assumptions was developed. These assumptions were applied to ten sample scenarios based on several different types of construction projects and then analyzed to determine the tax outcomes under each plan. In addition to the concepts developed by the CST Task Force, the 2014 tax policy, the current tax system including MRRA, the policy as proposed under the original 2013 legislation, and the policy proposed in 2016 were also analyzed using the same set of assumptions and scenarios. These individual project results were then extrapolated over a full year of revenue using the mix of actual 2014 revenues for the City of Chandler. Chandler was selected as the test city because all of the required data was readily available. Recognizing that there are clear differences among cities statewide, special attention was given by the CST Task Force to ensure the analysis was structured to allow variability in the mix of activities in any given city or town. In this way each jurisdiction can adjust these outcomes based on their local experience by identifying their revenue mix per scenario from 2014.

Each of the following concepts developed by the CST Task Force include the following properties:

- Expands the state shared revenue pool to include Use tax at the same rate as Retail.
- Eliminates MRRA in its current form.
- Allows “handymen” as defined by the Registrar of Contractors (ROC) to pay tax on the purchase price of materials to the retail vendor.
- Exempts construction materials purchased by all other licensed contractors from the retail tax at the vendor’s location.
- Maintains the current Prime Contracting method for all “heavy” construction involving infrastructure (highways, streets and bridges) and all contracts with a governmental body.

Dollar Limited

Establish a modified version of the prime contracting system, with two options for tax imposition determined by a specific dollar amount without any other limitations:

1. If the total contract price is less than X times the current ROC Handyman exemption amount (\$1,000), charge the customer tax on the materials selling price only, based on the Retail rate at the job site (Example: if X = 5, then any job < \$5,000 the contractor pays Retail tax on selling price of materials at the job site).

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2. If greater than the limit, Contracting tax on 65% of the total contract price at the job site.

Pros:

- Places revenues in the location where the construction activity occurs.
- Does not adversely impact the overall TPT system or other tax and fee systems.
- Provides fairness to small contractors by removing them from the 65/35 system.
- Relieves material sellers from the tax liability created under MRRA.
- Has simplicity and clarity regarding which jobs are not subject to Prime Contracting tax.
- Eliminates confusion over how to bid a given job.
- Threshold is indexed to ROC handyman exemption, allowing it to rise over time without legislative intervention (when the ROC exemption rises, so does this threshold).
- Does not create new opportunities for tax avoidance.

Cons:

- Does not ensure revenue neutrality for the taxing jurisdictions – revenue reductions will occur.
- Causes some contractors who have canceled TPT licenses to come back into the system.

Percentage Limited

Establish a modified version of the prime contracting system, with two options for tax imposition determined by a percentage of the total contract price without any other limitations:

1. If the price of the materials is less than X% of the total job, charge the customer tax on the materials selling price only, based on the Retail rate at the job site (Example: if X = 15, then any job where the value of materials is less than 15% of the total contract price, the contractor pays Retail tax on selling price of materials at the job site).
2. If greater than the limit, Contracting tax on 65% of the total contract price at the job site.

Pros:

- Places revenues in the location where the construction activity occurs.
- Does not adversely impact the overall TPT system or other tax and fee systems.
- Provides fairness to small contractors by removing them from the 65/35 system.
- Relieves material sellers from the tax liability created by MRRA.
- Provides better clarity regarding which jobs are not subject to Contracting tax.
- Reduces confusion over how to bid a given job.
- Does not create new opportunities for tax avoidance.

Cons:

- Does not ensure revenue neutrality for the taxing jurisdictions – revenue reductions will occur.
- Percentage based threshold will mean each job must be calculated with knowledge of material prices and total contract price.

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- Causes some contractors who have canceled TPT licenses to come back into the system.

Arizona Contracting Excise Tax (ACET)

Eliminate current Contracting classification. Establish a new system where all contractors are considered to be the Retailer of all parts and materials they install. Create a new excise tax to fill the gap in revenue that results from this systemic change.

1. ALL Contractors are taxed on Building Materials

- All materials and supplies that are consumed in a construction contracting job are purchased exempt from tax by all contractors.
- All contractors are subject to Retail tax on all building materials and supplies based on the selling price to the property owner/customer and are taxed at the job site.
- All current Retail deductions and exemptions allowed under ARS 42-5061 remain in place.

2. ACET is applied on new construction only

- Any contractor who meets any of the criteria below will be subject to the Arizona Contractor's Excise Tax (ACET):
 1. A prime contractor that builds a new structure (Residential/Commercial), or
 2. A prime contractor that adds to the square footage of an existing structure (Residential/Commercial), or
 3. A prime contractor who sells "improved" real property. (Residential/Commercial, similar to current Speculative Builder Tax).
- Tax is on gross receipts of any project listed above, sourced to the job location.
- The only allowable deduction is the factored ACET tax.
- Subcontractors continue to deduct their income from subcontracting as they do today.
- No 35% standard deduction nor any other deduction, exemption or exclusion allowed.
- The State rate should be based on a calculation that closely maintains revenue neutrality.
- The local ACET rate is to be determined by the city and paid to the city on the ADOR tax return, thus allowing the local control over a rate necessary for local revenue neutrality.
- This is an additional tax that is limited to "new" construction as identified above. It does not apply to any maintenance, repair, replacement, or remodel contract that involves an existing building unless there is an addition of new square footage. This tax is in addition to the tax to be imposed on contractors for the sale of materials used on a job.

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Pros:

- Places revenues in the location where the contracting activity occurs.
- Provides fairness to small contractors by removing them from the 65/35 system.
- Relieves wholesalers from the tax liability created by MRRA.
- Provides simplicity and clarity regarding how to bid a job.
- Does not create new opportunities for tax avoidance.

Cons:

- May not ensure revenue neutrality for all taxing jurisdictions – revenue reductions may occur.
- High likelihood that future changes such as adding exemptions for special interests will require frequent rate increases to maintain revenue levels.
- May adversely impact other tax and fee systems (development impact fees, etc.).
- Requires most contractors who have canceled TPT licenses to come back into the system unless exempt under the new “ROC Handyman” exemption.

The summary of the examined plans is attached in Appendix 7. An explanation of the assumptions and identification of the ten construction scenarios is in Appendix 8. Calculations of each scenario and its tax outcomes are in Appendix 9. The extrapolated impact of each plan on the annual revenues for the City of Chandler is attached as Appendix 10. The same extrapolation exercise was also performed for the state’s revenues, attached as Appendix 11.

OTHER ISSUES

Out of State Purchases & Use Tax

A portion of construction materials are purchased out of state. The state relies on the purchaser to self-report and pay Use tax on these materials. Compliance is an ongoing issue and would need to be addressed, first by providing more information and education to taxpayers and, ultimately through an audit program to ensure the appropriate taxes are being remitted. Use tax enforcement is necessary to ensure a level playing field for Arizona vendors that are liable for the full tax on Retail.

Unlike other forms of TPT, Use tax is not shared with local governments. In an analysis of the impacts of eliminating construction contracting and imposing a materials tax, the 2013 Transaction Privilege Tax Simplification Task Force assumed Use tax would be shared with cities and counties in the same manner as Retail taxes. The CST Task Force also recommends sharing of the Use tax revenues with cities and towns on the same basis as the Retail classification it mirrors as part of any reform efforts.

Development Impact Fees

Arizona has long had a policy of growth paying for itself. Any significant modification to our existing construction contracting tax will have a ripple effect on other policy areas, particularly on other revenues that have traditionally been used to fund the costs associated with growth,

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such as development impact fees. Currently, there are 34 cities and towns that have impact fees.

Under the existing development impact fee program, a city or town with a higher sales tax rate for construction activity is required to offset the difference between the revenues collected from the higher rate against the amount of impact fees collected. Twenty-three cities and towns have a differential rate for construction sales tax. Since moving to a “materials-only” system would result in an elimination of the differential tax rate, there would be less revenue to these cities and towns. A consequence of this shift in tax policy would result in development impact fees increasing in these communities and/or tax burden shifts to other parts of the system. Additionally, projected contracting tax revenues from new growth are also currently treated as a reduction of impact fees. This provision should be eliminated so these revenues could be used to mitigate the revenue loss associated with construction sales tax reform.

Impact of the Differences in Mix of Construction Activities

Each city and town has a different mix of construction activity. Some communities see a high degree of new construction while others may have very little new construction and a large amount of repair and remodel. Any change in construction contracting taxes will have an uneven effect on the various municipalities in the state. It was in an effort to address these differences that our current Maintenance, Repair, Replacement and Alteration (MRRA) system was developed.

Bonding and Pledged Revenues

Another consideration that would need to be addressed if Arizona’s construction sales tax system is changed is the impact on existing financial obligations of cities and towns. Most cities and towns engage in long term forecasting and planning. Capital programs are developed and service levels are established based on anticipated revenues. In some cases revenues generated from the existing construction sales tax system have been pledged to repay bonds that have already been issued. Bond repayment terms are typically 20 to 30 years. Any significant reduction in this revenue stream could jeopardize the ability to repay this existing debt or require shifting resources from other critical municipal services.

Additionally, if a change in tax policy results in significantly less revenue for local governments, this could adversely impact bonding capacity and available interest rates, potentially leading to a disruption of service delivery. For communities that are growing, this could unfavorably impact the delivery of needed infrastructure unless alternative revenues are found such as increasing other TPT rates.

Litigation & Protests

Proponents of a materials tax often cite the number of protests and the amount of litigation as a reason to modify our existing Contracting tax system. However, the majority of current litigation related to the Contracting classifications is due largely to interpretations of the many exemptions and deductions on specific materials or charges within this class. Since almost all of the most

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protested issues are exemptions that also exist under the Retail classification, a shift to imposing tax on the vendor would simply result in shifting the litigant to the retail seller in the future. Moving to a tax on materials would not reduce any of the tax controversy or audit risk if a new contracting tax system recreates all of the existing exemptions. It would simply shift those risks to a different taxpayer.

The CST Task Force contacted their counterparts in other states and found that litigation and protests are not uncommon in any state, and usually follow the ever-shifting rules and statutes relating to taxation. Annual statutory changes made each legislative session require almost continuous interpretation as taxpayers try to determine which of these changes impact their businesses and how. Similarly, constant legislative changes require the ADOR to adjust its position on settled issues, opening the door to new interpretations and new litigation.

FINDINGS AND CONCLUSIONS

Arizona relies heavily on a consumption-based tax policy. This policy creates a high degree of uncertainty in the revenues that can make up as much as 50 percent of the general fund for some communities. Construction sales taxes are a significant portion of this revenue stream.

Over the last several years, there have been many legislative proposals to change Arizona's construction sales tax policy. These legislative proposals have placed Arizona cities and towns in a reactive position. The work of the CST Task Force is an effort to provide an in-depth, comprehensive analysis of this issue that can be used to shape any proposed legislation and includes principles for stability, fairness and economic growth. Significant time and effort was spent in truly understanding the widespread implications on the construction industry, the state and its diverse communities.

In an ideal situation, the League would work with the legislature to propose legislation proactively that includes the findings of this report and the legislature would enact this legislation intact so that the ongoing discussions on this issue could be settled for the foreseeable future. Resolving this long-standing debate on construction sales tax would allow for better financial planning for the business community, the state, counties and cities and towns. However, the lack of consensus on this issue continues to make this difficult.

There is no simple solution that resolves every stakeholder's concerns but, as a result of the CST Task Force's exhaustive study process, there are fundamental conclusions that can be used in the analysis of any future legislation. These include:

- The state and local governments will experience a significant loss of revenue if the contracting tax is eliminated and replaced with a tax only on construction materials.

Through separate analyses, both the League of Arizona Cities and Towns Construction Sales Tax Task Force and the Joint Legislative Budget Committee have determined that eliminating contracting tax and replacing it with a tax only on materials will cost the state in excess of \$140 million annually. Counties and municipalities will also lose significant revenue under a "materials-only" tax. Additionally, if this tax is imposed at the retail location of the purchase of

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construction materials, the remaining revenues will not necessarily go to the communities in which the construction occurs.

- Much of the complexity that plagues the current contracting tax system is related to the many statutory exemptions and deductions allowed.

While it is politically unlikely these exemptions and deductions will be eliminated, any new tax policy that maintains these exemptions and deductions will also continue to have the same amount of litigation and audit risk and will do nothing to simplify the contracting tax system. Additionally, significant changes in how contracting activity is taxed will undoubtedly have unintended consequences that will be disruptive to both taxpayers and those governmental entities that rely on these critical revenues.

- The creation of the Maintenance, Repair, Replacement and Alteration (MRRA) tax system has created more complexity for taxpayers and should be modified to improve compliance and simplify the system.

Small contractors raised concerns about the impact of the contracting tax on their segment of the construction industry. Many of these concerns were addressed as part of the implementation of the 2013 TPT Simplification legislation (HB 2111). However, the statutory changes that created MRRA also had many unintended consequences that need to be resolved.

- Use tax should be made uniform across all jurisdictions with the state, county and local Use tax rates set at the same rate as Retail in each jurisdiction.

Use tax is intended to simply be the mirror of the tax on Retail. This discrepancy in our tax code creates an economic advantage to purchase goods from out-of-state businesses and unfairly burdens local businesses with paying a disproportionate share of taxes. Use tax should also be included in the regular Shared Revenue pool in the same manner as Retail tax. This was recommended by the 2013 TPT Simplification Task Force and should be included in any tax reform proposed by the legislature.

- The legislature should avoid undermining the principles of the state's existing transaction privilege tax system by making sweeping changes to our tax code for the benefit of one industry.

The state of Arizona's tax system has always operated on the principle of taxing gross receipts. No industry is taxed solely on materials. If this is enacted for the construction industry, it could lead other businesses to seek this same tax treatment.

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APPENDIX 1

League of Arizona Cities and Towns Construction Sales Tax Task Force

Chairman:

John Kross, Town Manager, Town of Queen Creek

Task Force Members:

Larry Price, Finance Director, City of Buckeye

Ryan Peters, Intergovernmental Affairs Coordinator, City of Chandler

Brian Wright, Finance Director, City of Eloy

Barbara Goodrich, Deputy City Manager, City of Flagstaff

John Olsen, Tax Compliance Manager, Town of Gilbert

Doug Sandstrom, Finance Director, City of Goodyear

Ben Ronquillo, Finance Director, City of Litchfield Park

Erik Montague, Finance Director, Town of Marana

Mickey Tait, Tax Administrator, City of Mesa

Kevin Burke, Town Manager, Town of Paradise Valley

Jonathan Hill, Sales Tax Administrator, City of Peoria

Sandra Schilling, Assistant Finance Director, City of Phoenix

Jeff Nichols, Chief Financial Officer, City of Scottsdale

Ken Jones, Chief Financial Officer, City of Tempe

Donald "Pat" Wicks, Finance Director, City of Yuma

Technical Analysis Team:

Sara Radbury, Senior Tax Auditor, City of Avondale

Zac Sharp, Lead Tax Auditor, City of Chandler

John Olsen, Tax Compliance Manager, Town of Gilbert

Kathleen Jackson, Senior Tax Auditor, Town of Gilbert

Mickey Tait, Tax Administrator, City of Mesa

LeeAnne Cardenas, Lead Tax Auditor, City of Mesa

Jonathan Hill, Sales Tax Auditor, City of Peoria

Nancy Salcido, Associate Sales Tax Auditor, City of Peoria

Miguel Teposte, Finance Supervisor - Tax, City of Phoenix

Phil Montalvo, Senior Tax Auditor, City of Phoenix

Gary Tasky, Tax & License Manager, City of Tempe

Pam Reinke, Finance Manager - Revenue, City of Tucson

League Staff:

Patrice Kraus, Legislative Director

Lee Grafstrom, Tax Policy Analyst

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APPENDIX 2

Stakeholder Issues and Concerns

Cities and Towns:

- Revenues need to stay in the city where the impact of the job occurs
- Revenue losses must be minimized to avoid other TPT tax increases, property tax increases, other service fees and charges, or service level decreases
- State shared and direct Contracting revenues are essential and often pledged to bond covenants that will impact the ability to pay current bonds and future borrowing
- Impact fees adopted in 2014 included tax rate differentials between Contracting and Retail, so removal of this tax will negatively change the impact fee calculations, ultimately increasing direct impact fees
- Tax has always been on the total activity and gross receipts, not just materials
- Contracting is major revenue source, particularly in growing areas
- Sets a precedent or principle of shifting the tax burden to a wholesale transaction and away from the final transaction to the consumer
- Non-compliance appears to be growing under the current system – Permits are going up, but revenues are going down without a clear pick up in Retail or MRRA

Counties:

- Revenues need to stay in the county where the impact of the job occurs
- Revenue losses must be minimized to avoid other TPT tax increases, property tax increases, other service fees and charges, or service level decreases
- Tax has always been on the total activity and gross receipts, not just materials
- Contracting is major revenue source, particularly for the rural counties that typically do not have material supplier Retail operations
- Sets a precedent or principle of shifting the tax burden to a wholesale transaction and away from the final transaction to the consumer
- Non-compliance appears to be growing under the current system – Permits are going up, but revenues are going down without a clear pick up in Retail or MRRA

State:

- Tax has always been on the total activity and gross receipts, not just materials
- Contracting is major revenue source
- Revenue losses should be minimized to avoid other tax increases or service reductions
- Non-compliance appears to be growing under the current system – Permits are going up, but revenues are going down without a clear pick up in Retail or MRRA

Stakeholder Issues and Concerns

MARRA Contractors (Handymen):

- 35% Labor is insufficient and unfair given their higher than normal labor element
- Filing 15 separate tax returns each month is burdensome
- Too difficult to know which jurisdiction each job is located in

Prime Contractors:

- Believe tax should only apply to materials
- Believe tax at the Retailer is easier, greater compliance, fewer tax return filers
- Believe Arizona is harder/more work than other states to comply with
- Most protested/litigated area of the TPT tax code
- Complaints that ADOR is requiring annual exemption certificates
- Inconsistency in tax treatment, both State vs. cities and from city to city
- A split system is unfair and too hard
- Want to make this the last change to the system

Hybrid (Doing both Prime and MARRA):

- Too difficult to determine if the job is MARRA or Prime Contracting, so many just choose one for all jobs, usually Prime (anecdotally, it appears some are choosing not to report)
 - Want all bids to be made on the same basis, either Prime or MARRA
 - Confusion over when it applies
 - Need a cleaner bright line
- DOR has told them they must choose and will be held accountable for the choice
- Differentiating inventory for MARRA vs Prime
- Some complain the vendors have cancelled all exemption certificates
- Complaints that ADOR is requiring annual exemption certificates
- Tax should only apply to materials
- Believe that tax at the Retailer is easier, greater compliance, fewer tax return filers

Materials Suppliers:

- Most have always been fully tax exempt, now will become new taxpayers
- Confusion in the DIY market; how they tax their own contracting activity
- Complaints that ADOR is requiring annual exemption certificates
- Pressure to move out of city / out of state to reduce tax burden and pricing
- Likely eventual shift of revenues from Retail to Use tax – not uniformly applied, low compliance, still relies on the Contractor to report and pay based on job site

Consumer Perspective:

- MARRA jobs are currently only taxed on materials; no change in price is expected.
- New construction real estate is sold on a negotiated price, with tax folded into builder's costs. A change in tax policy would not result in a reduction in selling price of real estate.

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APPENDIX 3

**PRINCIPLES OF A CONSTRUCTION ACTIVITY
TRANSACTION PRIVILEGE TAX AND USE TAX SYSTEM**

- ***Ensures tax revenues are remitted to the jurisdiction in which the activity occurs***
 - Transaction privilege taxes (TPT) related to contracting should be imposed at the job site to address the demand for additional local services resulting from the construction activity.

- ***Does not result in a significant reduction in revenues for the local or state governments***
 - The intent of taxation is to generate revenue to pay for government infrastructure and services. Revenue losses in one area result in a need to increase other taxes or fees, shifting the burden from one group of taxpayers to another, or cause services to be reduced.
 - Revenues from construction taxes have been pledged to support bond repayment and, in some cases, have been part of impact fee calculations. Changes to the system that materially impacts the amount of revenue collected would adversely affect these other policies.

- ***Maintains the integrity of other tax systems and policies***
 - Transaction privilege taxes in Arizona are imposed on gross receipts of the business activity. Changes in Contracting TPT should not undermine this basic tenet or it could adversely impact or lead to alterations in the imposition of other transaction privilege taxes, or impact local sales tax authority.

- ***Fairness for all similarly situated taxpayers***
 - All taxpayers within a subcategory of construction activity should be treated equitably, but inherent differences between the activities that are covered within the broader scope of the construction industry must be recognized.

- ***Easy to determine tax obligation and to comply with remittance***
 - Provides clarity for each type of taxpayer within the broad definition of construction about how the tax applies and the amount owed, particularly when bidding a job.

- ***Prevents tax avoidance by relocating or restructuring businesses***
 - Does not create unintended consequences or encourage tax avoidance, for example by moving businesses out of state, out of a city's jurisdiction, onto reservations, etc.

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APPENDIX 4

History of the Arizona Transaction Privilege Tax on Construction Contracting Activity



Origins – 1930's

- The Arizona Transaction Privilege Tax ("TPT") is created, effective April 30, 1933
- TPT was levied on gross income at various rates on a number of specifically identified business activities, such as Retail Sales, but Construction Contracting was not one of them



Origins – 1930's

- In 1937, the Legislature enacted TPT on the gross proceeds from Construction Contracting activity
- At the time, a case was pending in the AZ Supreme Court that would initially find the TPT imposed on Retail Sales applied to gross receipts from the activity of Construction Contracting, which was later reversed based on the new law



1940's

- In 1943, Superior Court held sales of material to a contractor were taxable Retail Sales
- Legislature enacted provision which exempted materials sold to a contractor for incorporation into work under a contract
- Governor vetoed, but Legislature overrode
- AZ Supreme Court declared the act unconstitutional



1940's

- In 1944, the AZ Supreme Court determined that a retailer's sales to contractors were nontaxable resales (*Crane v AZ State Tax Commission*)
- Basis for decision was that contractors were not the ultimate consumers of the property and the placement of materials in structures constituted a resale of property



1940's

- In 1945, the AZ Supreme Court held sales by a contractor to the Federal government were not exempt from tax, since the taxpayer was not a Retailer
- In 1947, the AZ Supreme Court overturned *Crane* and reaffirmed the determination that contractors are not making Retail Sales
- The holdings in these two cases are critical to the State's ability to tax construction projects for the Federal government because they confirm the tax is imposed on the seller, not the buyer



1950's

- In 1952, the Legislature exempted sales of materials to licensed contractors from the TPT if the materials were incorporated or fabricated into any structure, project, development or improvement in fulfillment of a contract
- The requirement that a contractor be licensed to qualify was eliminated in 1981, because persons could be deemed taxable contractors even if they did not meet the licensing requirements of the Registrar of Contractors



1950's

- In 1954, the Legislature changed the scope of the TPT by establishing exclusions for most service occupations, and also created a labor deduction for Contracting
- The labor deduction was comprised of payments made by the contractor for direct labor employed in construction



1950's

- In 1955 the AZ Supreme Court ruled that residential developers were not taxable as contractors if they had not contracted with others to build the homes prior to construction, even if they entered into a sale agreement before completion of a home
- The Court also ruled that contracting did not include owners who construct buildings on their own property



1960's

- In 1968, the Court of Appeals held a city could not impose its tax on a contractor working for the University of Arizona because any city tax passed through would impose a tax on the State
- This was overturned in 1971 by the Court of Appeals in *Tempe v Webb*, when the court ruled the tax was imposed on the contractor, even if the ultimate burden fell to the State
- The latter decision was consistent with TPT treatment of contracting projects with the Federal government



1960's

- Although the scope of the TPT excluded most services, issues arose regarding the taxability of services performed in conjunction with taxable activity.
- Generally, charges for services that are included or bundled within a taxable sale are also taxable when integral to the sale
- The first major case to deal with this issue was *Ebasco Services, Inc. v. State Tax Commission* (1969).



1960's

- In *Ebasco*, the contractor had a separate contract for engineering and design services related to a construction project
- The Court determined those services were not incidental to the contracting activity, because the taxpayer had a separate division that performed the services and such services were not uniformly performed by the contractor on all projects
- The services were not integral to the contracting business, so not taxable



1960's

- *Ebasco* also addressed the contractor's purchase of machinery and equipment on behalf of the customer via agency agreement, that would be exempt under the Retail classification if the owner had made the purchase
- The Court ruled the owner's reimbursement of those costs to the contractor should be excluded from the contracting tax base, because there was no change in ownership under the agency agreement



1960's

- *Ebasco* also addressed the contractor's purchase of machinery and equipment on behalf of the customer via agency agreement, that would be exempt under the Retail classification if the owner had made the purchase
- The Court ruled the owner's reimbursement of those costs to the contractor should be excluded from the contracting tax base, because there was no change in ownership under the agency agreement



1960's

- *Ebasco* is most frequently cited for stating the principle that any ambiguity in the imposition of a tax is to be construed against the tax, and similarly, any ambiguity in an exemption is to be strictly construed against the exemption



1970's

- In 1976 the AZ Supreme Court in *State Tax Commission v. Holmes & Narver* (1976), the Court established a three prong test to determine if normally exempt activities should be excluded from a taxable activity:
 - It can be readily determined which portion of the business is from nontaxable services, and
 - The amount of the service is not inconsequential to the total business, and
 - The services are not incidental to the contracting business



1970's

- In 1976, the Legislature enacted a land deduction in the contracting classification based on the sale price of the land, not to exceed its fair market value
- In 1979, the Court of Appeals ruled the value of land could be excluded from the contracting tax base for periods prior to enactment of the land deduction, because the sale of land did not constitute contracting and land transferred in a construction project was not part of the tax base



1970's

- In an early case dealing with contracting activity on Indian lands, in 1977 the AZ Supreme Court determined that a contractor engaging in construction activity pursuant to a contract with the Bureau of Indian Affairs was subject to the TPT
- The Court based its decision on the fact that Federal regulations did not preclude imposition of the TPT, and the tax was imposed on the contractor, not the tribe or their property



1970's

- In 1978 the Legislature made significant changes to the contracting provisions
- Subcontractors were exempted from the tax with proper documentation, and the incidence of the tax fell on Prime Contractors
- The deduction for labor was replaced with a straight 35% of the gross proceeds of sales from the contracting activity
- Brought in the definition of "Prime Contractor" and "Owner Builder"



1970's

- For State purposes, Owner-Builder means a person who improves real property for his own use
- An owner-builder who sells the improved property within 24 months after substantial completion is treated as a taxable prime contractor. An amendment to this provision in 1984 clarified that only the value of the improvements incorporated within the 24 month period would be taxable as prime contracting.



1980's

- In 1984 the Legislature changed the law to allow factoring of tax in place of requiring separate statement of tax for it to be exempt
- This conformed the treatment of TPT with New Mexico's gross receipts tax, following a U.S. Supreme Court decision which upheld that State's tax on projects with the Federal government



1980's

- *Bassett v Tucson* (1983) asked if an owner-builder who hired contractors to build a shopping center was subject to tax on its gross receipts from the sale of the property a year after completion and if so, would it be double taxation
- The court ruled the sale was subject to the City's TPT because the owner had improved real property and there was no double taxation because Tucson allowed a credit to the owner-builder for tax paid by the contractors



1980's

- In contrast, the Court of Appeals looked at the City of Phoenix definition of contractor in *Phoenix v Santa Anita Development* (1984) and determined that, while the taxpayer had sold improved real property, the proceeds were not subject to tax under contracting
- Unlike Tucson's definition of contracting, the Phoenix code required that a taxable contractor be acting pursuant to a contract



1980's

- In 1985 and 1986, the DOR issued a series of rulings holding that developers and homebuilders could conduct business in a Marketing Arm/Construction Arm structure to put the incidence of the tax on the construction activity rather than the sale price of the property
- All costs of construction must be included in the TPT tax base of the construction entity, intercompany transactions must be at arms length, and the construction entity must make a reasonable profit



1980's

- In 1987, the cities and towns in Arizona adopted the Model City Tax Code (MCTC) to eliminate the significant disparity among the local codes
- The MCTC provides for three different classifications of contracting activity: construction contracting, speculative builder and owner-builder



1980's

- For city purposes, an owner-builder is an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property
- A speculative builder is an owner-builder that sells or contracts to sell at any time homes or improved residential or commercial lots without a structure or to sell other types of improved real property prior to completion or before the expiration of 24 months of substantial completion



1990's

- In 1995, Governor Symington vetoed SB 1206, which would have repealed the TPT on Prime Contracting in favor of taxing the purchase of materials under Retail
- The veto pointed to an estimated of revenue loss in excess of \$50 million annually to the State plus an additional loss of \$20 million to cities and towns, and recognized the lack of concrete information available
- He stated the potential simplification was not worth the potential revenue loss, and incongruent with his policy agenda of repealing the income tax



Acknowledgements

Excerpts taken from "A History of Arizona's Prorated Privilege Tax on Contracting Activities" prepared in 2012 by Dalbitta.





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Cities AND Towns

WWW.AZLEAGUE.ORG
@AzCities

602-258-5786
1820 W. Washington Street
Phoenix, AZ 85007

**THE LEAGUE OF ARIZONA CITIES AND TOWNS
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APPENDIX 5

Issue	Arizona, 2014	Arizona, Today	California	Colorado	Hawaii	Nevada
New Construction	65% of contract price <u>If New Building is Sold:</u> State: 65% of construction costs plus 5% profit City: 65% of selling price	65% of contract price <u>If New Building is Sold:</u> State: 65% of construction costs plus 5% profit City: 65% of selling price	100% of materials, no labor. Contractor is either retailer or consumer depending on contract.	100% of materials, no labor. Tax is either on cost or selling price depending on contract	100% of cost of construction contract including labor	100% of cost of materials, no labor
Repair	65% of contract price	MRRA = tax on materials Non-MRRA = 65% of contract price	100% of materials, no labor. Contractor is either retailer or consumer depending on contract.	100% of materials, no labor. Tax is either on cost or selling price depending on contract	100% of cost of construction contract including labor	100% of cost of materials, no labor
Who is responsible for paying tax?	Prime contractors	Prime contractors Retailers to MRRA contractors Contractors reporting under MRRA	Contractor	Contractor	Prime and sub-contractors.	All contractors and retailers
Rate charged at job or vendor location?	Job Site	New construction = Job site MRRA job = vendor OR job site Non-MRRA Alteration = job site	Job site location	Job site location	Job site location	Job Site location
Labor charges?	35% Standard Contracting Deduction	35% is Non-taxable for new construction or non-MRRA repair	Non-taxable	Non-taxable	Taxable	Non-taxable
Government contracts	65% of contract price	Taxable for new construction or repair as described above (MRRA)	Taxable	Taxable	Taxable	100% of cost of materials, no labor
Highways, Streets, & Roads	65% of contract price	Taxable 65% of total contract	Taxable	Taxable	Taxable	100% of cost of materials, no labor

Issue	New Mexico	South Dakota	Texas	Utah	Washington
New Construction	100% of gross receipts on the contract price, including labor New construction that is sold is subject to tax based on the selling price	100% of cost of construction contract including labor	100% of materials, no labor. Contractor is either retailer or consumer depending on contract.	100% of materials no labor.	100% of cost of construction including labor subject to B&O tax; sales of new buildings subject to real estate excise tax, no B&O tax
Repair	100% of gross receipts on the contract price, including labor	100% of cost of construction contract including labor	Residential is 100% materials & no labor, non-residential includes 100% materials plus labor	100% of materials no labor.	100% of cost of construction including labor
Who is responsible for paying tax?	Construction contractor and retailers	Contractor and retailers	Contractor	Retailers	Construction prime contractors and retailers
Rate charged at job or vendor location?	Job Site location	Job site location	Job site location	Vendor location	Job Site location
Labor charges?	Taxable	Taxable	Non-Taxable unless non-residential repair	Non-taxable	Taxable
Government contracts	Taxable	Taxable	Taxable	Taxable	Taxable
Highways, Streets, & Roads	Non-taxable	Taxable	Taxable	Taxable	Taxable

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APPENDIX 6

Alternative Construction Sales Tax Plans & Descriptions

Status Quo

Tax materials only at point of purchase (POP); Use tax to 1st use/consumption site (contractor location or job site)

Lesko Original Plan

Tax materials only at point of purchase (POP); Use tax to 1st use/consumption site (contractor location or job site)

Cobb Plan

Tax Materials only at POP; add 2% tax on Const. Materials for distribution to locals; Dist. based on Building Permit values

Contractor as Retailer (Auto Repair)

Tax imposed on Contractor based on selling price of materials only, at job site. Share Use Tax like Retail to mitigate revenue loss.

Building Permit

No TPT tax or licenses through DOR; Collect a new tax/fee when Permit is issued; adjust amount due/refunded when Final/CofO is issued

Modified MRRA

Keep current MRRA limits; all Gov't is always Contracting; Adjust 65% to reflect materials value by job type (three or four classes of Contractor, each with its own %) Share Use Tax like Retail to mitigate revenue loss.

Simplified MRRA

Flatten out the "Handyman" so smallest remain unlicensed: Never performs a job over \$1,000, \$5,000, \$10,000 (?), except "Heavy" or Gov't? Then no license/exemption cert, etc. Just pay tax on POP. ALL others are ALWAYS Prime (one job over makes you Prime for all jobs after). Change Prime taxable from 65% to reflect material values (?) 50% (?). Share Use Tax like Retail to mitigate revenue loss.

Total Contracting

Split taxation of each transaction into Purchase/Consumption. Purchase portion of tax is on materials at POP for all at 1/2 of normal Retail rate; Consumption portion is assessed on Contractors selling price of the materials at job site at 1/2 of Retail rate. Share Use Tax like Retail to mitigate revenue loss.

Materials Plus Local Tax

Tax all material at Point of Purchase (POP) under Retail; Create local (City & County level) tax on sales price of new construction. Share Use Tax like Retail to mitigate revenue loss.

Modified Prime Contracting #1

Two classes: Handyman and Contractor. Handyman defined the same as ROC (All jobs < \$1,000). Handyman does not license, pays all tax to vendor. Contractor uses current rules, open to adjustment of the 35% Standard Contracting Deduction. Contractors who do Handyman jobs pay tax on material purchase price at job site. Share Use Tax like Retail to mitigate revenue loss.

Alternative Construction Sales Tax Plans & Descriptions

Dollar Limited

Three classes: Handyman, Repair, New Build. Handyman defined by ROC (All jobs < \$1,000). Handyman does not license, pays all tax to vendor. Repair = all activity on existing structures, (excludes tear-down/rebuild) & pays tax on materials at job site on selling price under Retail. New Build uses current rules, open to adjustment of the 35% Standard Contracting Deduction. If New Build do Handyman/Repair jobs, tax material selling price at job site under Retail. Share Use Tax like Retail to mitigate revenue loss.

Percentage Limited

Scrap MRRA. All activity is Contracting as before. Any job with Materials <__% of total contract is taxed on selling price of materials only, under Retail at the job site. All others are Prime Contracting, with adjustment of the 35% Standard Contracting Deduction. Share Use Tax like Retail to mitigate revenue loss.

Labor Side Thinking

Tax actual labor at 2x the Retail rate. No tax on material for any licensed contractor (MRRA nor prime contractors). Labor already tracked for FICA, income tax purposes. Doesn't matter if contractor buys material for multiple sites in single purchase.

Value Added Tax (VAT)

Retail tax rate on the entire purchase price minus the cost of materials purchased. Contractor pays sales tax on the material/product purchased from the manufacturer or wholesaler. That entire cost is deducted from the final sales price of the product sold to the final user. The Retail tax is calculated on the balance.

Materials Plus Large Contracting

Start over. All materials taxed at vendor, with current exemptions under Retail; Use tax paid to contractor's location. For all projects of less than \$100,000 - no additional tax due or reported. All projects of \$100,000 or more are subject to a new State and Local Contractor Tax imposed at the job site, with no deductions, exemptions or exclusions, and a rate that is no larger than is needed to maintain revenue neutrality, i.e., 0.50% or 1% per jurisdiction.

AZ Contractor's Excise Tax (ACET) (SD Model)

Start over. All materials taxed at vendor, with current exemptions under Retail; Use tax paid to Job Site. ACRT applies to any contractor who builds a new structure, expands an existing structure, or sells improved real property. ACET is imposed on gross receipts at the job site, with no deductions, exemptions or exclusions, and a State/County/City combined rate that is low - between 1% and 2%.

Reform and Mitigation

REFORM - Two Contracting Tiers: Repair, New Construction. Repair - all activity on an existing structure (excludes tear-down/rebuild) pays tax on selling price of materials at job site. New Construction pays State and Local tax on the selling price using the current Standard Contracting Deduction, open to adjustment. (Handyman, defined by ROC, does not license, pays all tax to vendor.)

MITIGATE - Share Use Tax like Retail; Change the State level taxable measure on new construction to sales price; Modify existing Impact Fee law requiring an offset of some Contracting tax revenues; Phased/Delayed implementation.

* No change from the current version to a tax on Materials only will ever be revenue neutral. Local rate increases imposed across the other tax classifications or other factors will be needed to offset/mitigate losses. Add Use Tax to Shared Revenue pool equal to Retail. Allow cities to have higher Contracting tax rates without the Impact Fee offset.

Any form of tax on materials further exposes the current competitive price disadvantage faced by all Arizona Retailers versus out-of-state sellers because Use tax is not applied at the county level and is not uniformly applied by all cities and towns. This disparity gives an out-of-state seller a built-in price advantage of several percentage points.

To provide competitive fairness to Arizona companies, Use tax should be uniformly imposed at the same rate as the local Retail tax in all counties, cities and towns.

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APPENDIX 7

Alternative Construction Sales Tax Plans & Descriptions

Contracting 2014

All jobs taxed at the job site with a 35% Standard Deduction, ostensibly for Direct Labor.
(Repairmen and Handymen complained that 35% is far too low to represent their labor.)

Status Quo 2016

Prime Contracting and MRRA. All Prime Contracting remains the same as 2014. MRRA (Maintenance, Repair, Replacement, Alteration within set limits) is taxed on the purchase price of materials only, paid either to the vendor or by the contractor based on job site, as chosen by the contractor.

Lesko Original Plan - as introduced 2013

Tax materials only at point of purchase (POP); Use tax to site of 1st use/consumption (contractor business location or job site).

Cobb Plan - as introduced 2015

Tax Materials only at POP; Use tax to site of 1st use/consumption (contractor business location or job site). Add a new 2% tax on Construction Materials for distribution to cities; Distribution based on Building Permit values, or some other method to be determined.

Dollar Limited

Two classes: Prime Contracting and Retail Contracting. Retail Contracting = any activity on existing structures with a contract value less than 5 x the ROC Handyman exemption, never to exceed \$25,000. Retail Contractor jobs pay Retail tax on the selling price of materials to customer at the job site. Prime Contracting = all other construction including expansion of existing structures and sales of improved property. Prime Contracting jobs use current rules including 35% Standard Deduction. "Handyman" as defined by ROC does not license, pays all tax to vendor. Share the State Use Tax with cities and counties like Retail (40%) to mitigate revenue loss.

Percentage Limited

Scrap MRRA. All activity is Contracting as before. Any job with Materials <15% of total contract is taxed on selling price of materials only, under Retail at the job site. All others are Prime Contracting, with adjustment of the 35% Standard Deduction to 35%. "Handyman" as defined by ROC does not license, pays all tax to vendor. Share the State Use Tax with cities and counties like Retail (40%) to mitigate revenue loss.

AZ Contractor's Excise Tax (ACET)

Start over, generally based on the SD tax system. For all construction jobs, contractor pays Retail tax on the selling price of materials to customer at the job site. ACET only applies to a person who builds a new structure, expands an existing structure, or sells improved real property. ACET is imposed on total gross receipts at the job site, with no deductions, exemptions or exclusions, and a low State/County/City combined tax rate - 1% allocated 0.50% to the city, 0.25% to county, 0.25% to State. "Handyman" as defined by ROC does not license, pays all tax to vendor. Share the State Use Tax with cities and counties like Retail (40%) to mitigate revenue loss.

* No change from the current version to a tax on materials only will ever be revenue neutral. Local rate increases imposed across the other tax classifications or other factors will be needed to offset/mitigate losses.

Add Use Tax to Shared Revenue pool equal to Retail. Allow cities to have higher Contracting tax rates without the Impact Fee offset

Any form of tax on materials further exposes the current competitive price disadvantage faced by all Arizona Retailers versus out-of-state sellers because Use tax is not applied at the county level and is not uniformly applied by all cities and towns. This disparity gives an out-of-state seller a built-in price advantage of several percentage points.

To provide competitive fairness to Arizona companies, Use tax should be uniformly imposed in the same manner and at the same rate as the local Retail tax in all counties, cities and towns.

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APPENDIX 8

ASSUMPTIONS AND SCENARIOS TO EXAMINE PLANS FOR REVENUE IMPACT

General Assumptions that Apply to All Scenarios

- 1) All materials purchased in-state are picked up at the vendor location
- 2) All materials purchased from out-of-state are delivered to the job site
- 3) Materials are marked up by 20% to determine selling price when needed
- 4) All contractors are properly licensed and report correctly under each plan
- 5) For greater uniformity, all jobs occur in the City of Chandler and all vendors have the same business location in each scenario: Phoenix, Glendale, and Portland, OR
- 6) The ROC "Handyman" exemption is equal to \$1,000

Scenarios

- 1) Production Home construction and sale, using the Contracting Arm/Marketing Arm treatment
- 2) Custom Home construction and sale, using the Contracting Arm/Marketing Arm treatment
- 3) Commercial Property construction for a known Speculative Builder, using the Contracting Arm/Marketing Arm treatment
- 4) Commercial Property construction built for use by the Owner/Customer
- 5) Highway construction
- 6) Maintenance Contract
- 7) Repair Contract
- 8) Small Repair Contract
- 9) Minor Alteration Contract
- 10) Major Alteration Contract

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APPENDIX 9

Contracting Revenue Examples by Plan: Production Home Scenario

Alpha Construction purchases land within Chandler, AZ to build 150 production homes. The cost to build each home is \$150,000. Each home is sold by Alpha Marketing for \$200,000. The costs incurred per home are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Alpha Construction reports its activity to ADOR based on total cost (minus deductible costs) plus 5%, and Alpha Marketing reports its activity to the City based on the selling price minus deductible costs, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$10,000
Non-deductible	80,000
Total	\$90,000 60.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$40,000
Glendale, AZ	5,000
Portland, OR (No AZ Nexus)	15,000
Total	\$60,000 40.00%

Selling Price (20% Mark-up)
\$48,000
6,000
18,000
\$72,000

Total Contract Costs \$150,000

\$200,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "Prime"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is subject to ACET at a 1% total rate: 0.25% to State, 0.25% to County, 0.50% to City

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$5,351	\$5,351	\$3,360	\$3,360	\$3,360	\$5,351	\$4,939	\$4,528	\$4,116	\$5,351	\$4,939	\$4,528	\$4,116	\$4,032	\$500	\$4,532
Maricopa County	669	669	0	0	0	669	617	566	515	669	617	566	515	504	500	1,004
Chandler	1,853	1,853	225	225	225	1,853	1,710	1,568	1,425	1,853	1,710	1,568	1,425	1,080	1,000	2,080
Maricopa County			280	280	280											
Phoenix			920	920	920											
Maricopa County			35	35	35											
Glendale			145	145	145											
2% City Distribution Pool				900												
Total Tax	\$7,872	\$7,872	\$4,965	\$5,865	\$4,965	\$7,872	\$7,267	\$6,661	\$6,056	\$7,872	\$7,267	\$6,661	\$6,056	\$5,616	\$2,000	\$7,616

Contracting Revenue Examples by Plan: Custom Home

Bravo Construction executes a contract to build a custom home in Chandler, AZ. The total cost of construction is \$800,000. The final sale price of the new custom home by Bravo Marketing is \$1,250,000. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Bravo Construction reports its activity to ADOR based on cost (minus deductible costs) plus 5%, and Bravo Marketing reports its activity to the City based on the selling price minus deductible costs, unless a particular proposal dictates an alternate approach.

Contractor Costs		Percentage of Total Cost	This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.				Assumptions	
Deductible	\$30,000							- Contracting 2014: Scenario falls under "Prime Contracting"
Non-deductible	450,000							- Status Quo 2016: Scenario falls under "Prime"
Total	\$480,000	60.00%						- Modified Prime 2: Scenario falls under "Prime"
								- Modified Prime 3: Scenario falls under "Prime"
								- ACET: Scenario is subject to ACET at a 1% total rate: 0.25% to State, 0.25% to County, 0.50% to City
								Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.
Building Materials								
Vendor Location	Cost		Selling Price (20% Mark-up)					
Phoenix, AZ	\$110,000		\$132,000					
Glendale, AZ	60,000		72,000					
Portland, OR (No AZ Nexus)	150,000		180,000					
Total	\$320,000	40.00%	\$384,000					
Total Contract Costs	\$800,000		\$1,250,000					

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$29,429	\$29,429	\$17,920	\$17,920	\$17,920	\$29,429	\$27,166	\$24,902	\$22,638	\$29,429	\$27,166	\$24,902	\$22,638	\$21,504	\$3,125	\$24,629
Maricopa County	3,679	3,679	0	0	0	3,679	3,396	3,113	2,830	3,679	3,396	3,113	2,830	2,688	3,125	5,813
Chandler	11,895	11,895	2,250	2,250	2,250	11,895	10,980	10,065	9,150	11,895	10,980	10,065	9,150	5,760	6,250	12,010
Maricopa County			770	770	770											
Phoenix			2,530	2,530	2,530											
Maricopa County			420	420	420											
Glendale			1,740	1,740	1,740											
2% City Distribution Pool				3,400												
Total Tax	\$45,003	\$45,003	\$25,630	\$29,030	\$25,630	\$45,003	\$41,541	\$38,080	\$34,618	\$45,003	\$41,541	\$38,080	\$34,618	\$29,952	\$12,500	\$42,452

Contracting Revenue Examples by Proposal: Commercial Property Built for Subsequent Sale

Charlie Construction executes a contract to build an office/warehouse facility in Chandler, AZ for the owner, who identifies himself as a Speculative Builder for City tax purposes. The total contract for construction is \$10,000,000. The final sale price of the new office/warehouse facility by the owner, Speculative Office Buildings, is \$12,500,000. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Charlie Construction reports its activity to ADOR based on contract value (minus deductible costs), and Speculative Office Buildings reports its activity to the City based on the selling price minus deductible costs, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$600,000
Non-deductible	5,600,000
Total	\$6,200,000 62.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$1,250,000
Glendale, AZ	300,000
Portland, OR (No AZ Nexus)	2,250,000
Total	\$3,800,000 38.00%

Selling Price (20% Mark-up)
\$1,500,000
360,000
2,700,000
\$4,560,000

Total Contract Costs \$10,000,000

\$12,500,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "Prime"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is subject to ACET at a 1% total rate: 0.25% to State, 0.25% to County, 0.50% to City

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$359,268	\$359,268	\$212,800	\$212,800	\$212,800	\$359,268	\$331,632	\$303,996	\$276,360	\$359,268	\$331,632	\$303,996	\$276,360	\$255,360	\$31,250	\$286,610
Maricopa County	44,909	44,909	0	0	0	44,909	41,454	38,000	34,545	44,909	41,454	38,000	34,545	31,920	31,250	63,170
Chandler	116,025	116,025	33,750	33,750	33,750	116,025	107,100	98,175	89,250	116,025	107,100	98,175	89,250	68,400	62,500	130,900
Maricopa County			8,750	8,750	8,750											
Phoenix			28,750	28,750	28,750											
Maricopa County			2,100	2,100	2,100											
Glendale			8,700	8,700	8,700											
2% City Distribution Pool				31,000												
Total Tax	\$520,202	\$520,202	\$294,850	\$325,850	\$294,850	\$520,202	\$480,186	\$440,171	\$400,155	\$520,202	\$480,186	\$440,171	\$400,155	\$355,680	\$125,000	\$480,680

Contracting Revenue Examples by Plan: Commercial Property Built for Owner Use

Delta Construction executes a contract to build an office/warehouse facility for Owner in Chandler, AZ. The total contract price is \$10,000,000, and Owner will be using the facility to expand its own operations. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Delta Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$600,000
Non-deductible	5,600,000
Total	\$6,200,000 62.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$1,250,000
Glendale, AZ	300,000
Portland, OR (No AZ Nexus)	2,250,000
Total	\$3,800,000 38.00%

Selling Price (20% Mark-up)
\$1,500,000
360,000
2,700,000
\$4,560,000

Total Contract Costs \$10,000,000

\$10,000,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "Prime"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is subject to ACET at a 1% total rate: 0.25% to State, 0.25% to County, 0.50% to City

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$359,268	\$359,268	\$212,800	\$212,800	\$212,800	\$359,268	\$331,632	\$303,996	\$276,360	\$359,268	\$331,632	\$303,996	\$276,360	\$255,360	\$25,000	\$280,360
Maricopa County	44,909	44,909	0	0	0	44,909	41,454	38,000	34,545	44,909	41,454	38,000	34,545	31,920	25,000	56,920
Chandler	91,650	91,650	33,750	33,750	33,750	91,650	84,600	77,550	70,500	91,650	84,600	77,550	70,500	68,400	50,000	118,400
Maricopa County			8,750	8,750	8,750											
Phoenix			28,750	28,750	28,750											
Maricopa County			2,100	2,100	2,100											
Glendale			8,700	8,700	8,700											
2% City Distribution Pool				31,000												
Total Tax	\$495,827	\$495,827	\$294,850	\$325,850	\$294,850	\$495,827	\$457,686	\$419,546	\$381,405	\$495,827	\$457,686	\$419,546	\$381,405	\$355,680	\$100,000	\$455,680

Contracting Revenue Examples by Plan: Highway Construction

Echo Construction executes a contract with ADOT to build the Chandler Freeway, a five mile long, six-lane highway connecting Southeast Chandler to Northwest Chandler at a price of \$500,000,000. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Echo Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$20,000,000
Non-deductible	425,000,000
Total	\$445,000,000 89.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$10,000,000
Glendale, AZ	5,000,000
Portland, OR (No AZ Nexus)	40,000,000
Total	\$55,000,000 11.00%

Selling Price (20% Mark-up)
\$12,000,000
6,000,000
48,000,000
\$66,000,000

Total Contract Costs \$500,000,000

\$500,000,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "Prime"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is not subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

** NOTE: The Lesko and Cobb plans exclude any changes to highway construction. The CST Proposals include this activity in the proposed changes.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	** Lesko Plan (35% Std Ded.)	** Cobb 2016 Plan (35% Std Ded.)	** Cobb 2017 Plan (35% Std Ded.)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$17,472,000	\$17,472,000	\$17,472,000	\$17,472,000	\$17,472,000	\$17,472,000	\$16,128,000	\$14,784,000	\$13,440,000	\$17,472,000	\$16,128,000	\$14,784,000	\$13,440,000	\$3,696,000		\$3,696,000
Maricopa County	2,184,000	2,184,000	2,184,000	2,184,000	2,184,000	2,184,000	2,016,000	1,848,000	1,680,000	2,184,000	2,016,000	1,848,000	1,680,000	462,000		462,000
Chandler	4,680,000	4,680,000	4,680,000	4,680,000	4,680,000	4,680,000	4,320,000	3,960,000	3,600,000	4,680,000	4,320,000	3,960,000	3,600,000	990,000		990,000
Maricopa County																
Phoenix																
Maricopa County																
Glendale																
2% City Distribution Pool																
Total Tax	\$24,336,000	\$24,336,000	\$24,336,000	\$24,336,000	\$24,336,000	\$24,336,000	\$22,464,000	\$20,592,000	\$18,720,000	\$24,336,000	\$22,464,000	\$20,592,000	\$18,720,000	\$5,148,000	\$0	\$5,148,000

Contracting Revenue Examples by Plan: Maintenance Contract

Foxtrot Construction executes a contract with the Chandler Office Tower to provide ongoing building maintenance for one year at a total contract price of \$120,000. Under the contract, Foxtrot will change all air filters each month, and will change light bulbs and add air conditioning coolant as needed. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Foxtrot Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs where applicable, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$0
Non-deductible	108,000
Total	\$108,000 90.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$6,000
Glendale, AZ	3,000
Portland, OR (No AZ Nexus)	3,000
Total	\$12,000 10.00%

Selling Price (20% Mark-up)
\$7,200
3,600
3,600
\$14,400

Total Contract Costs \$120,000

\$120,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "MRRRA"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is NOT subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (MRRRA)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$4,368	\$672	\$672	\$672	\$672	\$4,368	\$4,032	\$3,696	\$3,360	\$4,368	\$4,032	\$3,696	\$3,360	\$806	\$0	\$806
Maricopa County	546	0	0	0	0	546	504	462	420	546	504	462	420	101		101
Chandler	1,170	45	45	45	45	1,170	1,080	990	900	1,170	1,080	990	900	216		216
Maricopa County		42	42	42	42											
Phoenix		138	138	138	138											
Maricopa County		21	21	21	21											
Glendale		87	87	87	87											
2% City Distribution Pool				180												
Total Tax	\$6,084	\$1,005	\$1,005	\$1,185	\$1,005	\$6,084	\$5,616	\$5,148	\$4,680	\$6,084	\$5,616	\$5,148	\$4,680	\$1,123	\$0	\$1,123

Contracting Revenue Examples by Plan: Repair Contract

Golf Construction executes a contract with the Chandler Fashion Center to repair damaged toilets at a total contract price of \$20,000. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Golf Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs where applicable, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$0
Non-deductible	17,000
Total	\$17,000 85.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$3,000
Glendale, AZ	-
Portland, OR (No AZ Nexus)	-
Total	\$3,000 15.00%

Selling Price (20% Mark-up)
\$3,600
-
-
\$3,600

Total Contract Costs \$20,000

\$20,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "MRRRA"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Retail"
- **ACET:** Scenario is NOT subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (MRRRA)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$728	\$168	\$168	\$168	\$168	\$728	\$672	\$616	\$560	\$728	\$672	\$616	\$560	\$202		\$202
Maricopa County	91	0	0	0	0	91	84	77	70	91	84	77	70	25		25
Chandler	195	0	0	0	0	195	180	165	150	195	180	165	150	54		54
Maricopa County		21	21	21	21											
Phoenix		69	69	69	69											
Maricopa County		0	0	0	0											
Glendale		0	0	0	0											
2% City Distribution Pool				60												
Total Tax	\$1,014	\$258	\$258	\$318	\$258	\$1,014	\$936	\$858	\$780	\$1,014	\$936	\$858	\$780	\$281	\$0	\$281

Contracting Revenue Examples by Plan: Small Repair Contract

Hotel Construction executes a contract with a resident of Chandler to repair damaged toilets in their home at a contract price of \$2,400. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Hotel Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs where applicable, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$0
Non-deductible	2,100
Total	\$2,100 87.50%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$100
Glendale, AZ	100
Portland, OR (No AZ Nexus)	100
Total	\$300 12.50%

Selling Price (20% Mark-up)
\$120
120
120
\$360

Total Contract Costs \$2,400

\$2,400

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "MRRRA"
- **Modified Prime 2:** Scenario falls under "Retail"
- **Modified Prime 3:** Scenario falls under "Retail"
- **ACET:** Scenario is NOT subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (MRRRA)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$87	\$17	\$17	\$17	\$17	\$87	\$81	\$74	\$67	\$87	\$81	\$74	\$67	\$20	\$0	\$20
Maricopa County	11	0	0	0	0	11	10	9	8	11	10	9	8	3		3
Chandler	23	2	2	2	2	23	22	20	18	23	22	20	18	5		5
Maricopa County		1	1	1	1											
Phoenix		2	2	2	2											
Maricopa County		1	1	1	1											
Glendale		3	3	3	3											
2% City Distribution Pool				4												
Total Tax	\$122	\$25	\$25	\$29	\$25	\$122	\$112	\$103	\$94	\$122	\$112	\$103	\$94	\$28	\$0	\$28

Contracting Revenue Examples by Plan: Minor Alteration Contract (Commercial)

India Construction executes a contract with the Chandler Residential Suites to remodel the lobby at a total contract price of \$250,000. The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. India Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs where applicable, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$10,000
Non-deductible	140,000
Total	\$150,000 60.00%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$50,000
Glendale, AZ	20,000
Portland, OR (No AZ Nexus)	30,000
Total	\$100,000 40.00%

Selling Price (20% Mark-up)
\$60,000
24,000
36,000
\$120,000

Total Contract Costs \$250,000

\$250,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "MRRRA"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is NOT subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (MRRRA)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$8,736	\$5,600	\$5,600	\$5,600	\$5,600	\$8,736	\$8,064	\$7,392	\$6,720	\$8,736	\$8,064	\$7,392	\$6,720	\$6,720		\$6,720
Maricopa County	1,092	0	0	0	0	1,092	1,008	924	840	1,092	1,008	924	840	840		840
Chandler	2,340	450	450	450	450	2,340	2,160	1,980	1,800	2,340	2,160	1,980	1,800	1,800		1,800
Maricopa County		350	350	350	350											
Phoenix		1,150	1,150	1,150	1,150											
Maricopa County		140	140	140	140											
Glendale		580	580	580	580											
2% City Distribution Pool				1,400												
Total Tax	\$12,168	\$8,270	\$8,270	\$9,670	\$8,270	\$12,168	\$11,232	\$10,296	\$9,360	\$12,168	\$11,232	\$10,296	\$9,360	\$9,360	\$0	\$9,360

Contracting Revenue Examples by Plan: Major Alteration Contract (Residential)

Juliett Construction executes a contract with a Chandler resident to remodel their home, which has a FMV of \$200,000, for a total contract price of \$75,000 (37.5% of FMV). The costs incurred are identified below, along with estimated selling prices of materials (used for some scenarios) assuming a 20% markup. All materials from in-state vendors are picked up at the vendor location; all materials from out-of-state vendors are delivered to the job site. Juliett Construction reports its activity to ADOR and the City based on total Contract Price minus deductible costs where applicable, unless a particular proposal dictates an alternate approach.

Contractor Costs	Percentage of Total Cost
Deductible	\$2,000
Non-deductible	38,000
Total	\$40,000 53.33%

Building Materials	
Vender Location	Cost
Phoenix, AZ	\$15,000
Glendale, AZ	5,000
Portland, OR (No AZ Nexus)	15,000
Total	\$35,000 46.67%

Selling Price (20% Mark-up)
\$18,000
6,000
18,000
\$42,000

Total Contract Costs \$75,000

\$75,000

This Version of the Scenarios can be adapted to show the effects as if these jobs occurred in your city/town. By adding your own distribution of TPT revenues, it will also illustrate a potential degree of impact each proposal could produce.

	City/Town	City Rate	County	County Rate
Job Site - Cont.	Chandler	1.500%	Maricopa County	0.700%
Job Site - Retail	Chandler	1.500%	Maricopa County	0.700%
Job Site - Use tax	Chandler	1.500%	Maricopa County	0.000%
Vendor A	Phoenix	2.300%	Maricopa County	0.700%
Vendor B	Glendale	2.900%	Maricopa County	0.700%

Assumptions

- **Contracting 2014:** Scenario falls under "Prime Contracting"
- **Status Quo 2016:** Scenario falls under "Prime"
- **Modified Prime 2:** Scenario falls under "Prime"
- **Modified Prime 3:** Scenario falls under "Prime"
- **ACET:** Scenario is NOT subject to ACET

Note: This scenario and the related calculations are provided for the sole purpose of comparing the various alternative taxing structures relative to each other. Assumptions have been made regarding the application of the concepts and the tax rates to be applied. No direct inferences should be made regarding the actual amount of total tax revenues that may be received from any one taxing structure based on these scenarios alone.

Estimated Tax Revenues

Jurisdiction	Contracting 2014 (35% Std Ded.)	Status Quo (35%; MRRRA) (Prime)	Lesko Plan (Retail @ POP; Use tax @ Site)	Cobb 2016 Plan (Retail @ POP; Use @ Site; + 2% City Pool)	Cobb 2017 Plan (Retail @ POP; Use @ Site; Pool 4% City Retail)	Dollar Limited (35%; 5xROC)	Dollar Limited (40%; 5xROC)	Dollar Limited (45%; 5xROC)	Dollar Limited (50%; 5xROC)	Percentage Limited (35%; <15%)	Percentage Limited (40%; <15%)	Percentage Limited (45%; <15%)	Percentage Limited (50%; <15%)	Arizona Contractor's Excise Tax (ACET)		
														Retail	ACET @ 1%	TOTAL
State of Arizona (5.6%)	\$2,657	\$2,657	\$1,960	\$1,960	\$1,960	\$2,657	\$2,453	\$2,248	\$2,044	\$2,657	\$2,453	\$2,248	\$2,044	\$2,352	\$0	\$2,352
Maricopa County	332	332	0	0	0	332	307	281	256	332	307	281	256	294		294
Chandler	712	712	225	225	225	712	657	602	548	712	657	602	548	630		630
Maricopa County			105	105	105											
Phoenix			345	345	345											
Maricopa County			35	35	35											
Glendale			145	145	145											
2% City Distribution Pool				400												
Total Tax	\$3,701	\$3,701	\$2,815	\$3,215	\$2,815	\$3,701	\$3,416	\$3,132	\$2,847	\$3,701	\$3,416	\$3,132	\$2,847	\$3,276	\$0	\$3,276

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APPENDIX 10

City/Town of	Chandler
FY 2014 Total TPT Revenue	\$95,000,000
FY 2014 Contracting Revenue	\$9,780,645

FY 2016 Total: **\$109,505,753**
FY 2016 Contracting: **\$8,855,057**

Plan	Scenario	Tract Home	Custom Home	Commercial - For Sale	Commercial - Own Use	Highways Roads	Maintenance	Repair	Small Repair	Minor Comm. Alteration	Major Res. Alteration	Est. FY 2014 Rev. by Plan
	Est. % of Total 2014 Contracting Revenue	20.0%	5.0%	15.0%	20.0%	15.0%	2.5%	2.5%	5.0%	7.0%	8.0%	100.0%
Contracting 2014	One Job	1,853	11,895	116,025	91,650	4,680,000	1,170	195	23	2,340	712	--
	Est. Total	\$1,956,129	\$489,032	\$1,467,097	\$1,956,129	\$1,467,097	\$244,516	\$244,516	\$489,032	\$684,645	\$782,452	\$9,780,645
Status Quo 2016	One Job	1,853	11,895	116,025	91,650	4,680,000	45	69	2	1,150	0	--
	Est. Total	\$1,956,129	\$489,032	\$1,467,097	\$1,956,129	\$1,467,097	\$9,404	\$86,521	\$48,067	\$336,471	\$0	\$7,815,947
Lesko Plan 2013	One Job	225	2,250	33,750	33,750	4,680,000	45	69	2	1,150	345	--
	Est. Total	\$237,587	\$92,503	\$426,757	\$720,342	\$1,467,097	\$9,404	\$86,521	\$48,067	\$336,471	\$379,271	\$3,804,020
Cobb Plan 2016	One Job	270	2,420	35,300	35,300	4,680,000	54	72	3	1,220	365	--
	Est. Total	\$285,104	\$99,492	\$446,357	\$753,424	\$1,467,097	\$11,285	\$90,283	\$52,247	\$356,952	\$401,257	\$3,963,498
Cobb Plan 2017	One Job	920	2,530	28,750	28,750	0	138	0	3	580	145	--
	Est. Total	\$971,465	\$104,014	\$363,534	\$613,625	\$0	\$28,840	\$0	\$60,607	\$169,698	\$159,404	\$2,471,187
Dollar Limited (35%)	One Job	1,853	11,895	116,025	91,650	4,680,000	1,170	195	23	2,340	712	--
	Est. Total	\$1,956,129	\$489,032	\$1,467,097	\$1,956,129	\$1,467,097	\$244,516	\$244,516	\$489,032	\$684,645	\$782,452	\$9,780,645
Percentage Limited (35%)	One Job	1,853	11,895	116,025	91,650	4,680,000	1,170	195	23	2,340	712	--
	Est. Total	\$1,956,129	\$489,032	\$1,467,097	\$1,956,129	\$1,467,097	\$244,516	\$244,516	\$489,032	\$684,645	\$782,452	\$9,780,645
ACET	One Job	2,080	12,010	130,900	118,400	990,000	216	54	5	1,800	630	--
	Est. Total	\$2,196,355	\$493,760	\$1,655,186	\$2,527,067	\$310,347	\$45,141	\$67,712	\$112,854	\$526,650	\$692,581	\$8,627,654

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APPENDIX 11

Arizona	Contracting
FY 2014 Collected State Tax	\$563,368,333
Shared (Cities & Counties)	\$112,673,667
Net to State	\$450,694,666

FY 2016	Contracting	MRRA	Totals
Collected	\$480,061,417	\$8,006,247	\$488,067,664
Shared	\$96,012,283	\$3,202,499	\$99,214,782
Net to State	\$384,049,134	\$4,803,748	\$388,852,882

Plan	Scenario	Tract Home	Custom Home	Commercial - For Sale	Commercial - Own Use	Highways Roads	Maintenance	Repair	Small Repair	Minor Comm. Alteration	Major Res. Alteration	Est. FY 2014 Rev. by Plan
	Est. % of Total 2014 Contracting Revenue	20.0%	5.0%	15.0%	20.0%	15.0%	2.5%	2.5%	5.0%	7.0%	8.0%	100.0%
Contracting 2014 35% Std. Labor	One Job	\$5,351	\$29,429	\$359,268	\$359,268	\$17,472,000	\$4,368	\$728	\$87	\$8,736	\$2,657	--
	Est. Total	\$112,673,667	\$28,168,417	\$84,505,250	\$112,673,667	\$84,505,250	\$14,084,208	\$14,084,208	\$28,168,417	\$39,435,783	\$45,069,467	\$563,368,333
	Shared	\$22,534,733	\$5,633,683	\$16,901,050	\$22,534,733	\$16,901,050	\$2,816,842	\$2,816,842	\$5,633,683	\$7,887,157	\$9,013,893	\$112,673,667
	Net to State	\$90,138,933	\$22,534,733	\$67,604,200	\$90,138,933	\$67,604,200	\$11,267,367	\$11,267,367	\$22,534,733	\$31,548,627	\$36,055,573	\$450,694,666
Status Quo 2016 35%; MRRA	One Job	\$5,351	\$29,429	\$359,268	\$359,268	\$17,472,000	\$672	\$168	\$17	\$5,600	\$2,657	--
	Est. Total	\$112,673,667	\$28,168,417	\$84,505,250	\$112,673,667	\$84,505,250	\$2,166,801	\$3,250,202	\$5,417,003	\$25,279,348	\$45,069,467	\$503,709,071
	Shared	\$22,534,733	\$5,633,683	\$16,901,050	\$22,534,733	\$16,901,050	\$866,721	\$1,300,081	\$2,166,801	\$10,111,739	\$9,013,893	\$107,964,485
	Net to State	\$90,138,933	\$22,534,733	\$67,604,200	\$90,138,933	\$67,604,200	\$1,300,081	\$1,950,121	\$3,250,202	\$15,167,609	\$36,055,573	\$395,744,586
Lesko Plan 2013 All Retail/Use	One Job	\$3,360	\$17,920	\$212,800	\$212,800	\$17,472,000	\$672	\$168	\$17	\$5,600	\$1,960	--
	Est. Total	\$70,752,695	\$17,152,168	\$50,053,768	\$66,738,358	\$84,505,250	\$2,166,801	\$3,250,202	\$5,417,003	\$25,279,348	\$33,244,074	\$358,559,668
	Shared	\$28,301,078	\$6,860,867	\$20,021,507	\$26,695,343	\$16,901,050	\$866,721	\$1,300,081	\$2,166,801	\$10,111,739	\$13,297,630	\$126,522,817
	Net to State	\$42,451,617	\$10,291,301	\$30,032,261	\$40,043,015	\$67,604,200	\$1,300,081	\$1,950,121	\$3,250,202	\$15,167,609	\$19,946,445	\$232,036,851
Cobb Plan 2016 All Retail/Use +2% City Pool	One Job	\$3,360	\$17,920	\$212,800	\$212,800	\$17,472,000	\$672	\$168	\$17	\$5,600	\$1,960	--
	Est. Total	\$70,752,695	\$17,152,168	\$50,053,768	\$66,738,358	\$84,505,250	\$2,166,801	\$3,250,202	\$5,417,003	\$25,279,348	\$33,244,074	\$358,559,668
	Shared	\$28,301,078	\$6,860,867	\$20,021,507	\$26,695,343	\$16,901,050	\$866,721	\$1,300,081	\$2,166,801	\$10,111,739	\$13,297,630	\$126,522,817
	Net to State	\$42,451,617	\$10,291,301	\$30,032,261	\$40,043,015	\$67,604,200	\$1,300,081	\$1,950,121	\$3,250,202	\$15,167,609	\$19,946,445	\$232,036,851
Cobb Plan 2017 All Retail/Use Pool 4% City Retail	One Job	\$3,360	\$17,920	\$212,800	\$212,800	\$17,472,000	\$672	\$168	\$17	\$5,600	\$1,960	--
	Est. Total	\$70,752,695	\$17,152,168	\$50,053,768	\$66,738,358	\$84,505,250	\$2,166,801	\$3,250,202	\$5,417,003	\$25,279,348	\$33,244,074	\$358,559,668
	Shared	\$28,301,078	\$6,860,867	\$20,021,507	\$26,695,343	\$16,901,050	\$866,721	\$1,300,081	\$2,166,801	\$10,111,739	\$13,297,630	\$126,522,817
	Net to State	\$42,451,617	\$10,291,301	\$30,032,261	\$40,043,015	\$67,604,200	\$1,300,081	\$1,950,121	\$3,250,202	\$15,167,609	\$19,946,445	\$232,036,851
Dollar Limited 35%; 5x ROC (< \$5,000)	One Job	\$5,351	\$29,429	\$359,268	\$359,268	\$17,472,000	\$4,368	\$728	\$87	\$8,736	\$2,657	--
	Est. Total	\$112,673,667	\$28,168,417	\$84,505,250	\$112,673,667	\$84,505,250	\$14,084,208	\$14,084,208	\$28,168,417	\$39,435,783	\$45,069,467	\$563,368,333
	Shared	\$22,534,733	\$5,633,683	\$16,901,050	\$22,534,733	\$16,901,050	\$5,633,683	\$5,633,683	\$11,267,367	\$15,774,313	\$9,013,893	\$131,828,190
	Net to State	\$90,138,933	\$22,534,733	\$67,604,200	\$90,138,933	\$67,604,200	\$8,450,525	\$8,450,525	\$16,901,050	\$23,661,470	\$36,055,573	\$431,540,143
Percentage Limited 35%; 15%	One Job	\$5,351	\$29,429	\$359,268	\$359,268	\$17,472,000	\$4,368	\$728	\$87	\$8,736	\$2,657	--
	Est. Total	\$112,673,667	\$28,168,417	\$84,505,250	\$112,673,667	\$84,505,250	\$14,084,208	\$14,084,208	\$28,168,417	\$39,435,783	\$45,069,467	\$563,368,333
	Shared	\$22,534,733	\$5,633,683	\$16,901,050	\$22,534,733	\$16,901,050	\$5,633,683	\$5,633,683	\$11,267,367	\$15,774,313	\$9,013,893	\$131,828,190
	Net to State	\$90,138,933	\$22,534,733	\$67,604,200	\$90,138,933	\$67,604,200	\$8,450,525	\$8,450,525	\$16,901,050	\$23,661,470	\$36,055,573	\$431,540,143
ACET Materials: Retail at Job Site Add'l 1% on Total New Contract	One Job	\$4,532	\$24,629	\$286,610	\$280,360	\$3,696,000	\$806	\$202	\$20	\$6,720	\$2,352	--
	Est. Total	\$95,431,909	\$23,573,703	\$67,414,993	\$87,926,532	\$17,876,111	\$2,600,162	\$3,900,242	\$6,500,404	\$30,335,218	\$39,892,889	\$375,452,162
	Shared	\$19,086,382	\$4,714,741	\$13,482,999	\$17,585,306	\$3,575,222	\$1,040,065	\$1,560,097	\$2,600,162	\$12,134,087	\$7,978,578	\$83,757,637
	Net to State	\$76,345,527	\$18,858,962	\$53,931,994	\$70,341,225	\$14,300,888	\$1,560,097	\$2,340,145	\$3,900,242	\$18,201,131	\$31,914,311	\$291,694,524

Base Revenue

Base Shared

Base Net State

(\$145,149,403)

\$18,558,332

(\$163,707,735)

(\$145,149,403)

\$18,558,332

(\$163,707,735)

(\$145,149,403)

\$18,558,332

(\$163,707,735)

\$59,659,262

\$23,863,705

\$35,795,557

\$59,659,262

\$23,863,705

\$35,795,557

(\$128,256,909)

(\$24,206,848)

(\$104,050,062)

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APPENDIX 12

Review of 1999 Andersen Noncompliance Study & Updates to Census Survey Data



Prepared for:



League of Arizona Cities and Towns

October 2016

Prepared by:



Elliott D. Pollack & Company
7505 East 6th Avenue, Suite 100
Scottsdale, Arizona 85251

Key Findings

In 1999, a report was commissioned by the Arizona Tax Research Association that analyzed shifting state TPT from prime contracting to materials. This report was produced by Arthur Andersen (hereinafter referred to as the Andersen study) and concluded that non-compliance by state contractors was as high as 43%. After our review of the Andersen Study and the source data from the U.S. Census and Arizona Department of Revenue, we conclude that the methodology employed in the Andersen Study was erroneous and significantly overstated potential non-compliance.

The Andersen study uses two main arguments to justify a large non-compliance estimate. One is that there are a significant number of non-employer businesses and they were not surveyed in the Economic Census. The second argument is that there is nearly double the number of active registered contractors listed on the Arizona Registrar of Contractors than there are registered contractors with state TPT licenses. Our conclusions to these arguments and other considerations are outlined below.

❖ **Non-employer businesses have ALWAYS been tracked by the Census but were ignored in the Andersen Study.**

The Andersen study asserted that the U.S. Census does not survey non-employers. This is a misleading statement. While non-employer businesses are not “surveyed”, their information is indeed collected. The Census explains within its methodology that “statistics on non-employers were obtained from administrative records of other agencies of the Federal Government”. Information on non-employers is derived from business income tax returns and matched to the Census employer file on the basis of common identification numbers. Through this method, a value of \$456.7 million in business receipts is reported for the 14,262 non-employer entities in 1992. While there are questions as to the complete accuracy of the non-employer data reported by the Census (non-employer establishments reporting over \$1 million in receipts were excluded), the magnitude of construction activity from these establishments is likely closer to the reported total of \$456.7 million than the colossal \$11.7 billion estimate that was provided in the Andersen study.

❖ **The Andersen Study skews non-compliance estimates by inflating non-employer activity.**

The Andersen Study incorrectly assigned every construction business entity an equal amount of business activity (\$818,685). They concluded that each of the 14,262 non-employer establishments created as much as \$11.7 billion in additional construction value that was not accounted for in the Economic Census. This is a gross overestimation of construction activity considering a relatively small number of large firms produce a significant majority of business activity. Indeed, from the 1992 survey we observe that there were 3,775 companies with 5 employees or more which represents only 17% of total establishments. Yet, these companies account for more than 88% of the total dollar value of business done. The Andersen study could have instead assigned more realistic characteristics to non-employer businesses, such as grouping them together with small employer establishments.

These factors combine to cast serious doubt on the methodology employed in the Andersen study. Ignoring or excluding the fact that non-employer establishments actually had a reported construction



value combined with the decision not to utilize small company characteristics to non-employer establishments skews the total construction value. This causes the total construction value to be over-reported which, compared to contracting tax receipts, also over-reports the magnitude of non-compliance.

As the Economic Censuses confirm, non-employers constitute a large part of the business universe in terms of number of establishments, but they contribute a relatively small portion of the overall sales and receipts data. While non-employer entities comprised 63% to 77% of all construction businesses, they likely only account for 5% to 10% of total business activity.

❖ **The Andersen Study repeats their error when comparing registered contractors to TPT licenses by incorrectly concluding that contractors without a TPT license create just as much construction activity as those with TPT licenses.**

The central issue with this approach is the inability to verify the claims due to the lack of access to the data utilized. There is a reported total for active registered contractors and a reported total for contracting TPT licenses but the source data is not displayed and there is no further explanation or descriptions within the report that help illustrate the reliability of this data.

While we do not have access to the Arizona Department of Revenue's database, we expect the same conceptual issue that existed with the Census and non-employer businesses may be true regarding the comparison of registered contractors on the Arizona Registrar of Contractors to TPT licenses. This is to say that there may be many contractors without TPT licenses, but they likely represent a small percentage of total construction activity. It is not that non-compliance does not exist; rather that the businesses creating the large majority of business activity are most likely being tracked. This leads to the likelihood that only a portion of the very small or single person businesses may be evading taxation.

Instead of considering these likelihoods, the Andersen study repeats its simplistic calculation of taking the total amount of contracting activity reported by the Arizona Department of Revenue divided by the number of registered TPT licenses and then multiplying by the total number of active registered contractors. This approach, to assign equal activity across all entities, results in a gross overstatement of non-compliance.

We recommend further analysis of this topic by the Department of Revenue to be able to fully understand the discrepancy.

❖ **There are comparability issues to Arizona Department of Revenue data that were not considered.**

Results from the Census are estimated based on a sample survey. Therefore they are subject to sampling variability as well as errors of response and non-reporting.

Secondly, the Census reports construction activity for all Arizona-based construction establishments regardless of where the construction work was performed, whereas the AZDOR gross tax receipts data refers to construction work performed in Arizona and thus taxable in the state. Information regarding the percent of work by Arizona companies performed outside of the state was introduced beginning



with the 1997 Census. Estimates for Arizona based companies and the percent of work performed outside of the state have ranged from 5.8% to 7.5% over the last 15 years.

Additionally, there is a very real likelihood that Arizona companies responding to the Census survey could be reporting gross construction value, similar to how they report to municipalities, instead of the reduced value allowed by the State. The Arizona Department of Revenue treats taxation differently among construction types such as home building. Home builders only report their construction value plus a fair profit to the State for taxation. This could be as little as 63% of the total sales price of the home and would not be captured in the calculation of construction value with Arizona Department of Revenue data.

If this is the case, the difference in reporting to the Census versus the Arizona Department of Revenue would be in the magnitude of billions of dollars of value, depending on the level of home building in a given year.

Through our review of the Andersen Study, we found no mention of these potentially significant issues. Therefore, comparing these two sources is inexact and should not be relied upon for estimates of non-compliance. We believe further research is warranted.

❖ **Non-compliance deserves a fresh look and the Andersen Study should not be the starting point.**

In our opinion, the approaches utilized in the Andersen study represent an incomplete method for estimating potential non-compliance within the state and should not be relied upon. While we assume that non-compliance does indeed occur, these data sources alone are not enough to calculate non-compliance with any degree of confidence.



1.0 Historical Census of Arizona Construction Activity

This section provides details from the last four Economic Censuses of Construction as well as non-employer data for the Arizona construction industry, all of which is collected and analyzed by the U.S. Census Bureau. The purpose of this section is to provide an update to reports previously published and to analyze the applicability of the data as it relates to important questions related to the taxation of construction activity in Arizona.

More specifically, this section addresses the question of whether or not Census data in comparison to Arizona Department of Revenue tax collections can accurately estimate potential non-compliance in reporting taxable construction activity. Information from each census also helps clarify issues in calculating non-compliance that were performed previously.

The 1999 Andersen study utilizes information gathered from the 1992 Census of Construction Industries. This Census provides state level data on the construction value performed in that given year. Further, this census is performed in 5-year increments and released approximately two years from the census year. Thus, the Andersen Study did not have access to the 1997 survey and was left to extrapolate data forward 7 years from the 1992 Census.

To date, the Census years of 1992, 1997, 2002, 2007 and 2012 are available to the public. The 2017 Census data would be released sometime in mid-2019.

1992 Census

In 1992, there were reported to be 22,568 construction companies within the state of Arizona. These companies reported an estimated \$10.9 billion in dollar value of business done. For companies with payroll, the estimated net value of construction (removing double counts from sub-contractors) was \$6.8 billion.

Non-employer establishments (establishments with no payroll are, for the most part, companies owned and operated by a single person) were estimated to have \$456.7 million in business receipts. The Census also points out that non-employer establishments reporting more than \$1 million in business activity were excluded on the assumption that the values were either misreported or duplicated in revenues reported by (or imputed to) firms with paid employees. It is unknown how many of these establishments were excluded from the Arizona total, though it is described as “a relatively small number”.

Due to the fact that there is no net calculation performed on the estimated value of non-employer business, it is inaccurate to simply add the net value of payroll construction value to the gross value of non-employer business value. However, it can be used for reference as a ceiling to total construction value performed in the state. Thus, a high estimate of total construction value in Arizona in 1992 is \$7.28 billion.



1992 Census of Construction		
All Establishments		
Number	Employees	\$ Value of Business Done
22,568	86,749	\$10,929,101,000
Establishments Without Payroll		
Number	Proprietors/partners	\$ Value of Business Done
14,262	13,798	\$456,728,000
Establishments With Payroll		
Number	Employees	\$ Value of Construction Work
8,306	86,749	\$10,323,979,000
Net Value of Construction for Establishments with Payroll		\$6,822,623,000
Source: U.S. Census		

1997 Census

In 1997, there were reported to be 31,969 construction companies within the state of Arizona. These companies reported an estimated \$19.9 billion in dollar value of business done. For companies with payroll, the estimated net value of construction (removing double counts from sub-contractors) was \$12.8 billion. In addition, non-employer establishments were estimated to have \$1.1 billion in business receipts. This would equate to a construction value ceiling of \$13.82 billion.

1997 Census of Construction		
All Establishments		
Number	Employees	\$ Value of Business Done
31,969	131,871	\$19,924,788,000
Establishments Without Payroll		
Number	Proprietors/partners	\$ Value of Business Done
20,911	NA	\$1,058,310,000
Establishments With Payroll		
Number	Employees	\$ Value of Construction Work
11,058	131,871	\$18,866,478,000
Net Value of Construction for Establishments with Payroll		\$12,761,962,000
Source: U.S. Census		



For the 1997 Census, data for establishments with no employees were no longer included in the construction reports. This data collection migrated to the Non-employer Statistics series which continues to provide non-employer data annually for the construction industry by state. Regarding non-employer characteristics, the Census states,

“Non-employer businesses are generally small, such as real estate agents and independent contractors. Although non-employers constitute a large part of the business universe in terms of number of establishments, they contribute a relatively small portion of the overall sales and receipts data.”

Furthermore, regarding the collection, accuracy, and publishing of this data, the Census states,

“Non-employer statistics data originate chiefly from administrative records of the Internal Revenue Service (IRS). Data are primarily comprised of sole proprietorship businesses filing IRS Form 1040, Schedule C, although a small percentage of the data is derived from filers of partnership and corporation tax returns that report no paid employees. These data undergo complex processing, editing, and analytical review at the Census Bureau to distinguish non-employers from employers, correct and complete data items, and form the final non-employer universe.”

2002 Census

In 2002, there were reported to be 37,180 construction companies within the state of Arizona. These companies reported an estimated \$28.6 billion in dollar value of business done. For companies with payroll, the estimated net value of construction (removing double counts from sub-contractors) was \$19.9 billion. In addition, non-employer establishments were estimated to have \$1.5 billion in business receipts. This would equate to a construction value ceiling of \$21.45 billion.

2002 Census of Construction		
All Establishments		
Number	Employees	\$ Value of Business Done
37,180	174,871	\$30,110,461,000
Establishments Without Payroll		
Number	Proprietors/partners	\$ Value of Business Done
24,189	NA	\$1,520,646,000
Establishments With Payroll		
Number	Employees	\$ Value of Construction Work
12,991	174,871	\$28,589,815,000
Net Value of Construction for Establishments with Payroll		\$19,926,458,000
Source: U.S. Census		



2007 Census

In 2007, there were reported to be 50,122 construction companies within the state of Arizona. These companies reported an estimated \$57.9 billion in dollar value of business done. For companies with payroll, the estimated net value of construction (removing double counts from sub-contractors) was \$42.5 billion. In addition, non-employer establishments were estimated to have \$2.4 billion in business receipts. This would equate to a construction value ceiling of \$44.88 billion.

2007 Census of Construction		
All Establishments		
Number	Employees	\$ Value of Business Done
50,122	219,036	\$57,874,226,000
Establishments Without Payroll		
Number	Proprietors/partners	\$ Value of Business Done
34,659	NA	\$2,367,112,000
Establishments With Payroll		
Number	Employees	\$ Value of Construction Work
15,463	219,036	\$55,507,114,000
Net Value of Construction for Establishments with Payroll		\$42,512,280,000
Source: U.S. Census		

2012 Census

In 2012, there were reported to be 50,122 construction companies within the state of Arizona. These companies reported an estimated \$57.9 billion in dollar value of business done. For companies with payroll, the estimated net value of construction (removing double counts from sub-contractors) was \$42.5 billion. In addition, non-employer establishments were estimated to have \$2.4 billion in business receipts. This would equate to a construction value ceiling of \$44.88 billion.



2012 Census of Construction		
All Establishments		
Number	Employees	\$ Value of Business Done
45,279	123,886	\$27,777,565,000
Establishments Without Payroll		
Number	Proprietors/partners	\$ Value of Business Done
34,702	NA	\$1,771,113,000
Establishments With Payroll		
Number	Employees	\$ Value of Construction Work
10,577	123,886	\$26,006,452,000
Net Value of Construction for Establishments with Payroll		
		\$19,361,806,000
Source: U.S. Census		

Conclusions

The Andersen study provides details of the 1992 Census and also uses the exclusion of non-employer establishments as the basis of calculating a new estimated total value of construction. This is to say that they attempted to determine how much construction value was generated by non-employer companies. However, their methodology grossly overestimates this construction value.

It is true that the 22,568 Arizona companies included in the 1992 Census of Construction Industries were identified into two groups: employers (companies with payroll) and non-employers (no payroll). Of the total, 14,262 companies were identified as non-employers which represent 63.2% of all construction entities. From the remaining 8,306 companies, all medium and large size employers were surveyed along with a sample of small employers. The survey was not required of non-employer companies.

Using the reported ratio of employers to non-employers, the authors of the Andersen study evenly distributed the amount of construction work across the 8,306 employer companies arriving at \$818,685 of construction value per establishment. This average value was then assigned to each of the 14,262 non-employer establishments to arrive at an additional \$11.7 billion in potential construction value not accounted for in the survey of employer companies. The two values were then aggregated to \$18.5 billion and then increased by 2% per year for 6 years to arrive at a 1998 estimate of \$20.8 billion.

The flaws in this approach are identified using additional information that was part of the 1992 Census but excluded from the Andersen study.

The first flaw is that over half of the employer establishments had less than 5 employees. The remaining 3,775 companies with 5 employees or more represents only 17% of total establishments yet they account for more than 88% of the total dollar value of business done. Thus, the Andersen study could have assigned more realistic characteristics to non-employer businesses, such as grouping them



together with small employer establishments. This casts high unlikelyhood that non-employer establishments would be producing construction values that were already skewed by larger employer establishments.

The second flaw is that the 14,262 non-employer establishments were not ignored in the study, they were just not surveyed. The Census explains within its methodology section that “statistics on non-employers were obtained from administrative records of other agencies of the Federal Government”. The information on non-employers was derived from business income tax returns and matched to the census employer file on the basis of common identification numbers. This is the reported value of \$456.7 million in business receipts which is included in the Census.

While there are questions as to the complete accuracy of this data (there is discussion that non-employer establishments reporting over \$1 million in receipts were excluded) the magnitude of business receipts from these establishments is likely closer to the reported total of \$456.7 million than the \$11.7 billion estimate provided in the Andersen study.

These factors combine to cast serious doubt on the methodology employed in the Andersen study. Ignoring or excluding the fact that non-employer establishments had a reported construction value combined with the decision not to utilize “small” company characteristics to non-employer establishments skews the total construction value. This causes the total construction value to be over-reported which, compared to contracting tax receipts, also over-reports the magnitude of non-compliance.



2.0 Census Construction Value vs. AZDOR Tax Receipts

An update to the analysis performed in the Andersen Study related to potential for non-compliance is addressed in this section.

The Andersen study provides details of the 1992 Census and manipulates that data to account for non-employer activity. This value is used to compare to Arizona Department of Revenue data on contracting and is the basis of calculating one potential value of non-compliance. This is to say that they attempted to determine how much construction value was not being taxed due to non-compliant establishments. However, the calculation was performed erroneously and should not be relied upon.

The Andersen study outlined some of the difficulties in comparing Census data to Arizona Department of Revenue data. However, after explaining the complications between these two data sources, the report then definitively concludes what the percentage of non-compliance among contractors in the State is likely to be.

One of the stated difficulties is that the results from the Census in the employer establishment category are estimated based on a sample survey. Therefore they are subject to sampling variability as well as errors of response and non-reporting.

Another major issue is that the Census reports construction activity for all Arizona based construction establishments regardless of where the construction work was performed, whereas the AZDOR gross tax receipts data refers to construction work performed in Arizona and thus taxable in Arizona. Therefore, comparing these two sources is inexact and should not be relied upon for estimates of non-compliance.

To help adjust for this discrepancy, the following table displays a percent of work performed out-of-state by Arizona based companies. This information was introduced beginning with the 1997 Census. Estimates for Arizona based companies and the percent of work performed outside of the state have ranged from 5.8% to 7.5%.

The ratio reported in 1999 was applied to the 1992 survey figures. This adjustment is still inexact. The amount reported for out of state is based on the total value of construction and not the net value of construction. To create a conservative estimate, the percentage was only applied to the net value of construction as opposed to the entire construction value performed out of state.

The following table is used as an update to the Andersen study with the correct reporting of non-employer business. As opposed to the 43% estimated non-compliance, Census comparisons for the last five economic census years shows a differential of 4.2% to 25.8%.

In our opinion, this is still an incomplete method for estimating potential non-compliance within the state and should not be relied upon. While we assume that non-compliance does indeed occur, these data sources alone are not enough to calculate non-compliance with any degree of confidence.



Comparison of Economic Census Value of Construction & Arizona Department of Revenue Reported Contracting Value State of Arizona					
	1992	1997	2002	2007	2012
U.S. Census Net Value of Construction for Arizona Businesses	\$6,822,623,000	\$12,761,962,000	\$19,926,458,000	\$42,512,280,000	\$19,361,806,000
% of Construction Work Performed Within Arizona	94.2%	94.2%	94.2%	92.5%	92.9%
Net Value Performed in Arizona	\$6,430,284,744	\$12,028,079,164	\$18,774,439,908	\$39,341,153,043	\$17,991,689,818
Nonemployer Value of Business	\$456,728,000	\$1,058,310,000	\$1,520,646,000	\$2,367,112,000	\$1,771,113,000
Upper Value of Total Construction Work	\$6,887,012,744	\$13,086,389,164	\$20,295,085,908	\$41,708,265,043	\$19,762,802,818
Calendar Year Construction Contracting Value	\$6,450,000,000	\$12,540,700,000	\$17,937,293,846	\$33,063,833,963	\$14,670,252,209
AZDOR Reporting as % of Economic Census Upper Value Estimate	93.7%	95.8%	88.4%	79.3%	74.2%
Source: U.S. Census; Arizona Department of Revenue					

Again, for comparison purposes only, historical Arizona Department of Revenue TPT collections of prime contracting from 2013 through 2015 are provided in the table below. In addition, the imputed value of construction work done is displayed along with the range of adjustments as reported in the previous table. For example, \$10.8 billion from contracting in the state was considered taxable in 2013. That implies approximately \$16.6 billion of construction activity occurred throughout Arizona (adjusting for the 35% labor deduction). Using the Andersen Study methodology to adjust for non-compliance, there would potentially have actually been \$17.4 billion to \$22.4 billion of construction work performed in the state.



Arizona Department of Revenue Prime Contracting TPT (\$ millions) 2013-2015				
	Taxable Sales	Imputed Value	Low Adjustment (4.2%)	High Adjustment (25.8%)
2013	\$10,820.3	\$16,646.7	\$17,371.0	\$22,425.3
2014	\$11,184.9	\$17,207.5	\$17,956.3	\$23,180.8
2015 ^{1/}	\$9,486.7	\$14,595.0	\$15,230.1	\$19,661.4
^{1/} Affected by change in TPT policy. Source: AZ Department of Revenue; U.S. Census; Elliott D. Pollack & Co.				

Recent changes in construction contracting taxation have further complicated the proposed method for calculating non-compliance. Per the Arizona Department of Revenue:

“Effective January 1, 2015, non-construction, or service contactors, were exempted from prime contracting on both the state and city levels. Contractors who only enter into contracts with owners of real property to maintain, repair, replace, or alter their property are subject to tax at the point of purchase (Retail) on the building materials used in those projects. All other contracting activity remains taxable under the current statutes.

As a result, there has been a shift in reported activity out of the Contracting category and into the Retail category. Statutory clarity for the policy changes came after the beginning of the year. As a result, it is best to look at impacts over several months rather than at individual months. In addition, a longer evaluation period than what we currently have will likely help explain long term impacts.

When comparing the taxable sales from February-November 2015 vs February-November 2014, we find that Retail sales are up \$4.6 billion while Contracting is down \$1.6 billion, though not all of the differences can be attributed to the law change. Unrelated to the law change, the motor vehicle taxable sales portion of Retail was up \$730 million and the Information/FIRE portion was up \$482 million. Related to the change (in part or in full) the Building Material, Wholesale and Miscellaneous Retail categories were up over \$1.6 billion. On the flip side, Specialty Construction and the other and unspecified Construction categories were down \$1.4 billion. We continue to look for opportunities to measure these impacts more specifically as more data becomes available.”

Now that businesses classified by the Census as construction companies (such as specialty construction companies) will no longer report under the contracting category within Arizona, the comparison to



Arizona Department of Revenue data would under-report total construction activity. If the Andersen Study methodology continues to be employed, this new policy to shift some construction contractors into the Retail category has the potential to misleadingly conclude additional non-compliance is taking place.

State TPT Collection Formula for Home Building vs. Census Reporting

There is a very real likelihood that Arizona companies responding to the Census survey could be reporting gross construction value, similar to how they report to municipalities, instead of the reduced value allowed by the State. The Arizona Department of Revenue treats taxation differently among construction types such as home building. Home builders only report their construction value plus a fair profit to the State for taxation. This could be as little as 63% of the total sales price of the home and would not be captured in the calculation of construction value with Arizona Department of Revenue data.

If this is the case, the difference in reporting to the Census versus the Arizona Department of Revenue would be in the magnitude of billions of dollars of value, depending on the level of home building in a given year.

For example, in the latest Economic Census reported for 2012, there were just over 10,000 closings reported by R.L. Brown with an average sales price of \$267,124. That equates to just over \$2.67 billion in value. Using National Association of Home Builder (NAHB) surveys of new construction cost, approximately 60% of the final home price is attributed to construction cost. Adding a 5% builder profit, the estimated amount taxable at the state level is just over \$1.68 billion. This means that just under \$1 billion in value was not statutorily taxable at the state level in 2012 but may have been reported to the Census in the 2012 survey.



3.0 Census Report on Costs of Materials

In addition to construction value performed in the state, the Economic Census also surveys establishments with payroll on their cost of materials. This data is displayed on the following table for the last five economic censuses that are available as of the writing of this report.

As shown on the following table, the cost of materials as a percent of total construction value has remained relatively constant over the last 20 years. Costs have fluctuated from a reported high of 41.8% of construction to a low of 36.7% of construction cost.

Cost of Materials, Components, Supplies, and Fuels As Reported in Historical Economic Census of Construction State of Arizona					
	1992	1997	2002	2007	2012
Net Value of Construction	\$6,822,623,000	\$12,761,962,000	\$19,926,458,000	\$42,512,280,000	\$19,361,806,000
Cost of Materials, Components, Supplies, & Fuels	\$2,848,631,000	\$5,095,300,000	\$7,312,967,000	\$16,146,324,000	\$7,624,534,000
Cost of Materials as % of Construction	41.8%	39.9%	36.7%	38.0%	39.4%
Source: U.S. Census					



Appendix –

Detailed Construction Value Data from the 2002, 2007 & 2012 Economic Census for the State of Arizona



Geographic area name	Arizona							
Year	2002							
Meaning of Type of construction code	Value of construction work (\$1,000)	Std of Error (%)	Value of new construction work (\$1,000)	Std of Error (%)	Value of additions, alterations, or reconstruction (\$1,000)	Std of Error (%)	Value of maintenance and repair (\$1,000)	Std of Error (%)
Total	\$28,589,815	2	\$23,119,806	2	\$3,422,333	2	\$2,047,676	2
Building construction, total	\$22,507,257	2	\$18,471,669	3	\$2,612,467	3	\$1,423,121	3
Single-family houses, detached and attached	\$13,224,780	3	\$11,759,894	4	\$915,639	5	\$549,247	6
Single-family houses, detached	\$12,534,024	4	\$11,188,343	4	\$857,664	5	\$488,017	7
Single-family houses, attached	\$690,756	8	\$571,551	10	\$57,975	14	\$61,230	12
Apartment buildings (2 or more units), such as rentals, apartment type condominiums and cooperatives	\$915,818	10	\$751,376	11	\$95,904	24	\$68,538	10
Manufacturing and industrial warehouses	\$466,305	23	\$361,375	29	\$56,592	9	\$48,338	12
Other manufacturing and light industrial buildings, such as factories, assembly plants, and industrial research	\$310,765	2	\$178,621	2	\$79,080	5	\$53,064	5
Hotels, motels, and tourist cabins	\$430,503	1	\$379,484	1	\$34,083	7	\$16,936	13
Office buildings	\$1,957,943	3	\$1,307,130	2	\$487,870	8	\$162,943	4
Stores, restaurants, and automobile service stations, and other commercial buildings	\$1,790,379	3	\$1,302,395	4	\$338,925	9	\$149,059	9
Commercial warehouses such as distribution buildings and mini-storage	\$313,922	5	\$233,414	4	\$52,612	11	\$27,896	16
Religious buildings	\$247,223	5	\$180,837	5	\$48,143	9	\$18,242	7
Educational buildings	\$1,441,147	2	\$913,655	3	\$267,859	5	\$259,633	2
Health care and institutional buildings	\$652,796	2	\$449,778	2	\$166,911	4	\$36,106	10
Public safety buildings such as prisons, police, and fire stations	\$334,401	2	\$302,606	2	\$19,814	11	\$11,981	34
Amusement, social, and recreational buildings	\$230,465	2	\$201,852	2	\$21,146	4	\$7,467	9
Other building construction	\$190,810	4	\$149,251	5	\$27,886	4	\$13,672	6
Nonbuilding construction, total	\$4,987,443	2	\$3,553,022	2	\$809,866	2	\$624,555	4
Highways, streets, and related work, such as installation of guardrails and signs	\$1,648,391	2	\$1,188,984	3	\$329,635	2	\$129,772	8
Private driveways and parking areas	\$236,236	13	\$127,373	8	\$32,955	22	\$75,908	23
Bridges and elevated highways	\$203,238	1	\$175,572	1	\$23,817	1	\$3,849	6
Sewers, water mains, and related facilities	\$858,517	4	\$673,692	3	\$99,176	9	\$85,649	10
Sewers, sewer lines, septic systems, and related facilities	\$467,828	6	\$379,154	6	\$50,791	13	\$37,883	15
Water mains, storage, and related facilities	\$390,689	4	\$294,538	3	\$48,385	10	\$47,766	14
Power and communication transmission lines, cables, towers, and related facilities	\$559,457	7	\$359,988	9	\$97,222	9	\$102,247	11
Power plants	\$218,952	1	\$105,160	0	\$6,552	1	\$107,241	3
Outdoor swimming pools	D	S	D	S	D	S	D	S
Other nonbuilding construction	D	S	D	S	D	S	D	S
Construction work, nsk	\$1,095,116	0	\$1,095,116	0	\$0	0	\$0	0



Geographic area name	Arizona								
Year	2007								
Meaning of Type of construction code	Value of construction work (\$1,000)	Std of Error (%)	Construction work: new construction (\$1,000)	Std of Error (%)	Construction work: additions, alterations, or reconstruction (\$1,000)	Std of Error (%)	Value of construction work: maintenance and repair (\$1,000)	Std of Error (%)	
Total	\$55,781,989	1	\$42,659,249	1	\$8,476,579	3	\$4,646,161	2	
Building construction, total	\$45,224,285	1	\$35,688,400	2	\$6,394,320	4	\$3,141,565	3	
Single-family houses, detached and attached	\$22,924,905	3	\$19,395,364	3	\$2,025,343	4	\$1,504,198	5	
Single-family houses, detached	\$21,520,341	3	\$18,391,995	3	\$1,818,027	4	\$1,310,320	6	
Single-family houses, attached	\$1,404,564	5	\$1,003,369	6	\$207,316	12	\$193,879	9	
Apartment buildings (2 or more units), such as rentals, apartment type condominiums and Dormitories and barracks	\$2,274,496	3	\$1,860,647	3	\$231,056	4	\$182,793	12	
Manufacturing and industrial warehouses	\$174,065	3	\$126,134	3	\$34,610	8	\$13,321	3	
Other manufacturing and light industrial buildings, such as factories, assembly plants, and Hotels, motels, and tourist cabins	\$903,777	4	\$671,871	4	\$157,575	10	\$74,331	9	
Office buildings	\$979,082	4	\$490,288	5	\$288,102	5	\$200,692	8	
Stores, restaurants, automobile service stations, parking garages, and other commercial buildings	\$2,777,433	1	\$2,323,386	1	\$390,090	5	\$63,958	4	
Commercial warehouses such as distribution buildings and mini-storage	\$3,769,637	3	\$2,620,535	2	\$799,058	6	\$350,044	8	
Religious buildings	\$4,656,018	4	\$3,650,775	4	\$718,750	8	\$286,494	8	
Educational buildings	\$935,310	5	\$685,917	6	\$122,901	5	\$126,493	9	
Health care and institutional buildings	\$295,215	9	\$209,881	11	\$44,678	9	\$40,657	5	
Public safety buildings such as prisons, police, and fire stations	\$2,301,683	9	\$1,589,439	4	\$626,043	31	\$86,201	6	
Farm buildings, nonresidential	\$1,764,067	4	\$966,273	4	\$663,896	5	\$133,898	12	
Amusement, social, and recreational buildings	\$441,443	5	\$320,627	3	\$83,830	21	\$36,986	21	
Other building construction	\$214,210	21	\$191,514	23	\$11,159	19	\$11,537	23	
Nonbuilding construction, total	\$10,557,703	2	\$6,970,849	2	\$2,082,259	6	\$1,504,596	4	
Highways, streets, and related work, such as public sidewalks, curbs, guardrails and signs	\$657,615	4	\$493,379	4	\$145,816	4	\$18,419	16	
Airport runways and landing fields	\$155,328	6	\$92,372	6	\$51,414	10	\$11,541	20	
Private driveways and parking areas, except garages	\$3,083,580	5	\$1,833,517	4	\$915,031	13	\$335,032	13	
Bridges and elevated highways	\$115,510	12	D	S	\$70,729	7	D	S	
Sewers, water mains, and related facilities	\$624,789	9	\$412,899	8	\$52,479	21	\$159,411	26	
Sewers, sewer lines, septic systems, and related facilities	\$381,082	9	\$289,953	11	\$60,848	11	\$30,281	14	
Water mains, storage, wells, and related facilities	\$2,235,307	3	\$1,709,706	3	\$185,822	6	\$339,779	5	
Oil and gas pipelines, pumping stations, storage tanks, and mains	\$1,058,797	5	\$790,076	5	\$102,129	8	\$166,592	7	
Power and communication transmission lines, cables, towers, and related facilities	\$1,176,510	4	\$919,630	4	\$83,693	9	\$173,187	7	
Power plants	\$231,830	8	\$112,961	7	D	S	D	S	
Power and cogeneration plants, except hydroelectric	\$506,153	9	\$328,648	5	D	S	D	S	
Power plants, hydroelectric	\$469,545	3	\$106,580	8	D	S	D	S	
Sewage and water treatment plants	\$442,399	4	D	S	D	S	D	S	
Mass transit, including railroad construction	\$27,146	2	D	S	D	S	D	S	
Conservation and development construction, such as dams, drainage canals and flood control	\$688,785	3	\$463,280	3	D	S	D	S	
Swimming pools	\$164,577	7	D	S	D	S	D	S	
Decks, residential type	\$112,477	7	\$79,928	9	D	S	D	S	
Fencing	\$785,330	9	\$595,998	9	\$106,775	8	\$82,557	20	
Outdoor recreational areas, such as outdoor athletic fields, courts, golf courses, and camp grounds	\$52,769	34	\$24,663	42	D	S	D	S	
Metal mines	\$309,058	13	\$235,442	15	\$25,073	19	\$48,543	6	
Nonmetallic mines	\$224,017	9	\$178,454	9	\$30,227	11	\$15,335	24	
Other nonbuilding construction	\$88,600	14	\$38,925	22	D	S	D	S	
	\$12,698	11	\$9,545	7	D	S	D	S	
	\$413,335	4	\$368,125	2	D	S	D	S	



Geographic area name	Arizona										
Year	2012										
	Number of establishments	Std of Error (%)	Number of employees	Std of Error (%)	Cost of materials, components, and supplies (\$1,000)	Std of Error (%)	Total value of business done (\$1,000)	Std of Error (%)	Net value of construction work (\$1,000)	Std of Error (%)	
TOTAL	10,577	3.1	123,886	1.1	\$7,624,534	1	\$26,250,281	0.8	\$19,361,806	0.9	
Construction of buildings	2,649	6.3	20,087	2.4	\$2,216,142	1.7	\$9,991,634	1.5	\$4,957,283	1.5	
New single-family housing construction (except for-sale builders)	468	14.9	2,249	9.1	\$175,374	11.7	\$669,641	11	\$351,153	11.8	
New multifamily housing construction (except for-sale builders)	8	32.3	129	12.3	\$34,844	5.4	D	S	\$66,040	5.9	
New housing for-sale builders	236	17.1	2,030	5.7	\$640,978	1.8	\$2,240,000	2.7	\$1,366,303	1.3	
Residential remodelers	1,305	9.9	5,457	6.2	\$216,642	7.9	\$783,315	6.5	\$537,696	6.1	
Industrial building construction	34	39	587	16.2	\$63,725	3.8	D	S	\$135,302	6.3	
Commercial and institutional building construction	598	11.3	9,635	2.6	\$1,084,580	2.1	\$5,983,731	1.6	\$2,500,789	2	
Heavy and civil engineering construction	555	10	22,261	1.4	\$1,233,633	1.4	\$4,896,504	1.1	\$4,105,784	1.1	
Water and sewer line and related structures construction	183	18.1	3,342	6	\$356,039	2.9	D	S	\$637,636	3.3	
Oil and gas pipeline and related structures construction	13	0	1,190	0.7	\$37,670	0.4	D	S	D	S	
Power and communication line and related structures construction	121	19.6	3,443	4.7	\$110,911	6.3	D	S	\$504,485	5.3	
Land subdivision	38 (s)	46.4	634	3.6	\$89,944	3.7	D	S	D	S	
Highway, street, and bridge construction	172	18.8	6,201	2.5	\$585,229	1.8	\$1,630,619	1.5	\$1,265,873	1.8	
Other heavy and civil engineering construction	27	14.9	7,452	0.8	\$53,841	6.7	D	S	\$1,133,105	1.1	
Specialty trade contractors	7,373	3.8	81,538	1.5	\$4,174,759	1.5	\$11,362,143	1.4	\$10,298,739	1.4	
Poured concrete foundation and structure contractors	405	16.3	4,902	6.9	\$242,009	6	\$617,976	5.8	\$541,586	6.2	
Structural steel and precast concrete contractors	47	17.3	2,513	3.3	\$114,864	4.1	\$392,014	2.8	\$372,391	2.7	
Framing contractors	158	26.6	2,697	6.5	\$183,976	8.7	\$326,057	8.3	\$292,880	7.6	
Masonry contractors	283	18.9	3,893	9.5	\$98,342	7	\$315,471	19.2	\$304,952	18.5	
Glass and glazing contractors	111	24.6	1,027	9.2	\$62,503	10.1	\$154,459	8.5	\$146,184	8.6	
Roofing contractors	401	15.5	4,537	6.3	\$276,051	7.2	\$688,621	6.3	\$641,256	6.1	
Siding contractors	17	0	199	0	\$5,714	0	D	S	\$17,575	0	
Other foundation, structure, and building exterior contractors	118	27.5	1,388	7.3	\$52,134	12.1	\$203,836	5.5	\$173,872	5.8	
Electrical contractors and other wiring installation contractors	1,223	9.8	14,282	3.3	\$746,855	3	\$2,121,029	2.9	\$1,929,294	3.1	
Plumbing, heating, and air-conditioning contractors	1,729	8.2	18,171	3.5	\$1,107,601	3.1	\$2,765,434	2.9	\$2,542,175	2.9	
Other building equipment contractors	57	18.7	1,449	4.6	\$78,716	4.3	\$259,515	3.6	\$252,691	3.1	
Drywall and insulation contractors	414	16.5	6,254	5.4	\$223,326	4	\$554,925	4.3	\$523,848	4.3	
Painting and wall covering contractors	547	15	3,242	8	\$75,375	8.1	\$286,912	8.2	\$278,028	8.2	
Flooring contractors	224	21.2	1,283	15.2	\$110,451	9.5	\$239,455	10.7	\$198,559	9.7	
Tile and terrazzo contractors	206	19.9	1,302	8.8	\$58,604	7.8	\$160,561	8.2	\$128,702	8.8	
Finish carpentry contractors	382	17.2	2,646	9.8	\$189,579	12.8	\$407,733	9.4	\$375,544	9.5	
Other building finishing contractors	61	19.3	719	13.6	\$23,935	14.2	D	S	\$82,835	12.7	
Site preparation contractors	437	13.3	6,354	4	\$266,852	4.6	\$1,077,633	3.4	\$918,025	3.4	
All other specialty trade contractors	553	14.1	4,680	5.6	\$257,874	6.8	\$683,593	6	\$578,343	5.1	

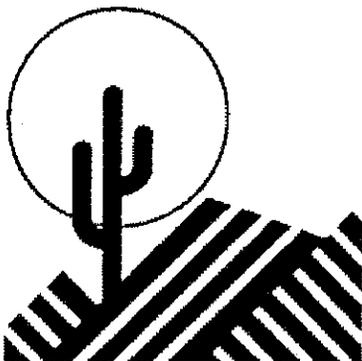


**THE LEAGUE OF ARIZONA CITIES AND TOWNS
CONSTRUCTION SALES TAX TASK FORCE REPORT:
AN EVALUATION OF ISSUES; CHALLENGES;
AND OPPORTUNITIES**



APPENDIX 13

**Analysis of the State Revenue Impact of
Shifting the Incidence of the State
Transaction Privilege Tax from Prime
Contracting to Materials**



ARIZONA TAX RESEARCH ASSOCIATION

1814 West Washington Street, Phoenix, Arizona 85007

(602) 253-9121

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Serving Arizona's Taxpayers Since 1940

**Analysis of the State Revenue Impact of
Shifting the Incidence of the State Transaction
Privilege Tax from Prime Contracting to
Materials**

Prepared for:

The Arizona Tax Research Association

Prepared by:

**Arthur Andersen
Phoenix, AZ**

February 11, 1999

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EXECUTIVE SUMMARY

Since the enactment of the state's first transaction privilege (TPT) and use tax in 1933, the contracting classification has been altered constantly by the legislative and judicial processes due to its complexity. The TPT is currently levied on the business of prime contracting while the acquisition of materials for incorporation into construction projects is exempt from tax.

The current state tax base is 65% of the gross proceeds of sales or gross income of the prime contractor with deductions for the fair market value of land and certain activities allowed under law. Other deductions are either specifically stated under the prime contracting classification or may be derived from the exemptions existing under the retail classification through use of an agency agreement (through December 31, 1998).

Throughout the history of the state's TPT on contracting, the courts have ruled on whether contracting was subject to tax under the tax structure, what the Legislature had exempted from tax, what was included in labor costs, and whether or not subcontracting was taxable. In 1978, the tax was changed to its current form by placing the incidence of the tax on the prime contractor and providing an in lieu of labor deduction.

The statutory language and judicial interpretations have made it difficult for the taxpayer to easily understand the tax and properly report what is owed. Even the question of whether or not a contractor is a prime contractor, who is subject to tax, or a subcontractor, who is not subject to tax, is a complex issue. This has resulted in additional administrative appeals, litigation and noncompliance.

By changing the incidence of the tax from prime contracting to the purchase of materials, the following results would occur:

- **An estimated state revenue increase of approximately \$50 million.**
- **An estimated decrease in noncompliance from a possible high of 43% to less than 5%, based on the State of California's experience.**
- **Reduction of the complexity of the tax, making it easier for the both the taxpayer and the Arizona Department of Revenue to determine the proper amount of tax owed.**
- **A decline in appeals and litigation due to simplification of the tax base.**
- **Conformity with the majority of other states. 80% of all states tax materials instead of the contractor, the contract or both contracting and materials (See Appendix A).**

OVERVIEW

A necessary element to understanding the Arizona tax on prime contracting is understanding the Arizona transaction privilege tax (TPT). Unlike a typical sales tax, the TPT is levied directly on the seller or vendor for the privilege of engaging or continuing in business within Arizona. The seller may then pass on the tax to the purchaser or absorb the tax. The seller is responsible for remitting the tax to the state. The tax is based on the gross proceeds of sales; gross receipts or gross income of the business charged at a varying rate (typically 5%) depending on the business classification the transaction falls into. Prime contracting is one of these classifications.

Counties and municipalities may also impose a similar tax on this activity, which increases the overall rate.

A. Contracting

The prime contracting classification includes the business of prime contracting and the selling and installation of new manufactured buildings. ARS §42-5075 states that “the tax base for the prime contracting classification is sixty-five per cent of the gross proceeds of sales or gross income derived from the business” less the deductions provided in statute, such as the sales price of land, not to exceed fair market value. The statute also defines “Contracting” as engaging in business as a contractor. “Contractor” is defined as being:

synonymous with the term "builder" and means any person, firm, partnership, corporation, association or other organization, or a combination of any of them that undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submit a bid to, or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, or to do any part thereof, including the erection of scaffolding or other structure or works in connection therewith, and includes subcontractors and specialty contractors. For all purposes of taxation or deduction, this definition shall govern without regard to whether or not such contractor is acting in fulfillment of a contract.
(ARS §42-5075 (F)(2))

The tax is applied only to a prime contractor, which is defined in the same section as the contractor who supervises or coordinates the contracting, including any subcontracting or specialty work, and is responsible for the completion of the contract. Subcontractors are not subject to tax as long as they can demonstrate that the job was under the control of a taxable prime contractor.

The history of this tax is replete with litigation and legislative enactments to deal with the adverse results arising from judicial decisions. See “History” attached as Appendix B.

B. Impact of Retail Exemptions

Because the TPT reaches 17 classifications of activity, there can be interaction among the provisions. The prime contracting classification can be impacted by the exemptions in the retail classification, which is defined as the business of selling tangible personal property at retail. There are two significant issues that arise as a result. Contractors are not retailers unless they have a separate retail business. Thus, a contractor must sell tangible personal property separately from contracting to be considered a retailer.

Second, through December 31, 1998 contractors had to use an agency agreement to exclude tangible personal property which would have been exempt if purchased by the owner at retail from the contracting tax base (see *Brink Electric Construction Co. et al v. Arizona Department of Revenue*, ARS §42-5075 (B)(7) and (C)(1)). An agency agreement authorized the prime contractor to purchase the exempt property on behalf of its customer and signaled the parties' intent that the contractor was the agent of the owner for purchasing purposes. To be effective, the contractor had to meet certain requirements that alter the normal way of doing business. Beginning January 1, 1999, contractors are able to deduct such exempt tangible personal property from the tax base without an agency agreement (Chapter 90, Laws 1998).

C. Taxable Contracting Activity – Examples

Taxable contracting activity affects or alters real property (buildings and land). Examples include construction of a building, improving land (paving, landscaping), tearing down, removing or moving walls, permanently affixing equipment to a structure, repairing equipment permanently affixed to a structure, installing flooring, and painting.

Fabrication of tangible personal property, which does not become real property, is not contracting. This includes the fabrication of a cleanroom, taking apart, moving and reconstructing modular furniture, and the fabrication of large pieces of equipment. Also, the cost of nontaxable services (i.e. engineering, and design fees) must be segregated from the taxable contracting activity in the contract to ensure that they are not taxed.

REVENUE IMPACT

A. Sources and Methodology

Five main data sources were utilized to analyze the revenue impact of the proposed change of the incidence of tax from prime contracting to materials incorporated in construction projects:

- 1) Census of Construction Industries
- 2) Arizona Department of Revenue
- 3) University of Arizona
- 4) Dun and Bradstreet
- 5) Current Construction Reports
 - a) F.W. Dodge
 - b) Bureau of the Census Reports

The information extracted from these major sources was supplemented by the following sources:

- Top 25 lists of Arizona based contractors in the areas of commercial contracting, mechanical contracting, electrical contracting, homebuilders, masonry contracting, highway and heavy construction contracting and telecommunications contracting from *The Business Journal*
- Employment data for the construction sector
- Arizona Economic Indicators for the construction sector
- Surveys among selected Arizona based contractors

Whenever possible we analyzed historical data as well as the most recently published data to establish trends and to make calculations and predictions more reliable. Quarterly and monthly data were aggregated to the Arizona fiscal year (July 1st to June 30th) and to a calendar year basis to validate and reconcile data from different sources. In order to assess the impact of the proposed tax change on the most recent fiscal year, linear time trend models were applied to obtain predictions. The time trend models were validated for existing data. Based on the different data sources, a variety of methods were pursued to arrive at a quantification of the revenue impact of the proposed tax change. These methods are explained in detail in the following sections.

B. Data Used to Quantify the Revenue Impact

A major source of data utilized in this study for the determination of the percentage of materials is the 1992 Census of Construction Industries. The Census covers all construction employer establishments primarily engaged in contract construction or construction on their own account for sale as defined in the *Standard Industrial Classification Manual (SIC)*. A construction establishment is defined as a relatively permanent office or other place of business where the usual business activities related to construction are conducted. The construction industry is divided into three broad types: (1) building construction, (2) heavy construction, and (3) special trade contractors. It should be pointed out that construction establishments may engage in various construction activities yet are assigned a single industry code based on their major

business activities. The data reported in the Census reports reflect both primary and secondary activities within the construction establishments.

The United States Bureau of the Census has taken this census in five-year intervals since 1967. Summary reports are prepared for the United States in total, as well as for individual states. Data from the 1997 Census is not yet available; therefore, the 1992 Census data was used.

The summary report from the 1992 Census of Construction Industries in Arizona includes data for all three types of construction as defined above, as well as data broken down for establishments with and without payroll.

1. Summary of 1992 Census of Construction Industries for Arizona

Census of Construction Data Detail

During 1992, 22,568 construction establishments in Arizona were included in the survey. A construction establishment was defined "as a relatively permanent office or other place of business where the usual business activities related to construction are conducted." A relatively permanent office was considered as an office that has been established for the management of more than one project, and which was maintained on a continuing basis. Of the 22,568 establishments, 14,262 had no payroll during the survey period or did not respond, and were excluded from the survey detail by the Census Bureau. The remaining 8,306 establishments accounted for the \$10.3 billion listed as the value of construction work done during 1992. Value of construction work was defined as "all construction work performed by general contractors and special trade contractors during 1992, including new construction, additions and alterations, reconstruction, maintenance and repair work, and any construction work done by the reporting establishments for themselves." Specialized machinery and equipment that was not an integral part of the structure was excluded.

The value of construction work done included some duplication of value, however, because construction work of one firm may be reported by another depending on which firm ultimately does the work. To avoid this duplication, the data included a net value of construction work done, which eliminated the value of construction reported by another entity. The duplicated work reported amounted to \$3.5 billion, leaving a net value of construction at \$6.8 billion. Of this total, the surveyed establishments paid out \$3.2 billion for the cost of materials, components, fuels, power, rentals, supplies, and the cost of selected purchased services. The cost for materials, components, and supplies alone amounted to \$2.7 billion or 26.2% of the total construction business of \$10.3 billion, which included duplicated work.

Material costs as a percentage of the total construction business remained fairly constant over the last 15 years, as reflected in the numbers for the census in 1987, 1982, and 1977, when the percentages were 25.7%, 29.1%, and 27.1% respectively. This results in a dollar-weighted average of 26.5% for the last four censuses, which is almost identical to the 26.2% from the 1992 Census; however, this needs to be adjusted to eliminate duplicated work. Thus, costs for materials, components and supplies needs to be expressed as a percentage of the net value of construction. For the 1992 Census the material cost amounted to 39.7% of the total net value.

Material costs as a percentage of the total net value of construction business also remained fairly constant over the last 15 years, as reflected in the numbers for the Census in 1987, 1982, and 1977, when the percentages were 40.6%, 45.8%, and 41.1% respectively. This results in a dollar-weighted average of 41.3% for the last four censuses, which is only slightly different from the 39.7% of the 1992 Census. Additional evidence for this number was found in a survey among contractors in Arizona conducted by Arthur Andersen in 1998. Cost for material, components and supplies amounted to approximately 46% of receipts among the surveyed contractors. We will use the four-census dollar weighted average of 41.3% for our calculations.

Limitations of the Census of Construction Data

The Census of Construction data only reflects 8,306 of the 22,568 construction establishments identified by the Bureau of the Census. 14,262 were excluded from the detail based on the fact that they reported no payroll for 1992 or did not respond to the survey. In addition, the excluded "nonemployer" establishments encompassed establishments that showed revenues of more than \$1 million. The Census Bureau assumed that it was unreasonable for such firms to raise large revenues without employees. However, many of these "nonemployer" establishments may have been created for tax planning purposes and therefore generated revenues that would be subject to the Arizona contracting tax. In addition, based on the Census Bureau's definition of establishment, any contracting work done at a site on a one-project or one-time basis would be excluded from the total value of construction work done. Any out-of-state company that established an office only for the duration of one project would be excluded from the survey regardless of the value of construction work done. We can only conclude, therefore, that this only represents a portion of the total construction work done in Arizona. However, the percentage of materials is still statistically valid based on the affirmation of the survey done.

Estimate of High-End of Total Construction Done

Based on the limitations of this data, we attempted to estimate the high-end of total construction done. If 8,306 of the 22,568 establishments, or 36.8%, account for \$6.8 billion in contracting (eliminating the duplication referred to previously), we must determine the amount we can attribute to the 14,262 establishments not reflected in the total. A rough estimate based on \$6.8 billion/8,306 multiplied by 14,262 results in an additional \$11.7 billion in contracting receipts, for a total of \$18.5 billion in total value of construction done for calendar year 1992. This amount can then be used to extrapolate the high-end estimate of total construction done in Fiscal Year 1998 by taking the amount and growing it 2% each year for six years. Since the calendar year determination would be the similar to the fiscal year one, we decided to use the calendar year amount as the fiscal year determination. Thus, the Census of Construction upper limitation for Fiscal Year 1998 is estimated at \$20.8 billion.

2. University of Arizona (UofA) Data, and Arizona Department of Revenue (ADOR) Data

Comparison of Data Detail with Census of Construction Data

Currently, the state tax on contracting is calculated on 65% of gross receipts, excluding the fair market value of land. Considering actual taxes collected in Fiscal Year 1992 as reported by

ADOR in the amount of \$196 million at a tax rate of 5%, taxable gross receipts are calculated at \$3.9 billion, which translates into total gross receipts of \$6.0 billion. This number compares to the \$6.8 billion for calendar year 1992 as reported in the Census of Construction for the 8,306 establishments that were reported on. The UofA reports monthly data for the construction sector based on ADOR's information on taxes collected. Since monthly UofA data was available through the end of 1997 and the deviation between UofA and ADOR data was negligible, the monthly UofA data for collected taxes was used to calculate the revenue impact of the proposed tax change.

Based on the UofA data for collected taxes, taxable gross receipts for the calendar year 1992 amounted to \$4.2 billion, which results in a figure of \$6.45 billion of gross receipts. This figure is slightly lower than the \$6.8 billion of net value of construction as reported in the Census of Construction. There are two possible explanations for this observed difference:

- I. The results from the Census in the employer establishment category are estimated based on a sample survey. Therefore they are subject to sampling variability as well as errors of response and non-reporting. The relative errors in the Census are typically in the range of +/- 5% margin. The \$6.45 billion as calculated from actual monthly UofA tax collection data corresponds to 95% of the estimated \$6.8 billion from the Census
- II. The Census reports construction activity for all Arizona based construction establishments regardless of where the construction work was performed, whereas the UofA tax gross receipts data refers to construction work performed in Arizona and thus taxable in Arizona.

In summary, we can conclude that the UofA data reconciles with the Census data for statistical comparison purposes and that the observations determined from the Census data can be used with the UofA data for our modeling purposes. However, the Census of Construction data and the UofA/ADOR data reflect different representative groups. The Census of Construction is based on the 8,306 establishments surveyed, while the UofA/ADOR data only reflects prime contractors paying tax. Although individual members of either group may exist within both groupings, there are differences between the two groups.

Limitations of UofA/ADOR Data

The UofA/ADOR data only reflect tax paid by the prime contractors because that is the activity upon which the current tax is collected. Under the new taxing scheme both prime contractors and subcontractors will pay tax on materials; therefore, all contracting must be quantified in the state.

Although, the current system is supposed to reflect all prime contracting, it is clear that noncompliance exists. For example, the Arizona Registrar of Contractors shows 35,940 active registered contractors in Arizona as of January 1, 1998, while the Arizona Department of Revenue has only 18,792 contractors registered for state TPT purposes as of the end of 1997. Since the TPT licenses only reflect prime contractors and there is no breakdown available regarding the contractors registered with the Registrar, it can be assumed that at least some of

these contractors are subcontractors. Even if this were true, subcontractors must still obtain TPT licenses and any subcontractor can easily become a prime contractor at any time once they supervise or coordinate the contracting activity.

These statistics also do not reflect any work done by non-registered and non-licensed individuals who are doing contracting work and not paying sales tax on the materials used. Based on this information, we can conclude that this data does not accurately reflect the total value of construction work done in Arizona, just as the Census of Construction does not.

Estimate of High-End of Total Construction Done

Based on the limitations of the UofA/ADOR data, we also attempted to quantify the upper limit of total construction work done. Based on the fact that only 52% of all registered contractors in Arizona have state TPT licenses, we can estimate the upper limit for Fiscal Year 1998 as \$12.9 billion (See Table 1 under "D. Summary of Revenue Impact")/18,792 multiplied by 35,940 resulting in \$24.7 billion in total contracting work done in Arizona.

3. Dun and Bradstreet (D & B) Data

D & B Data Detail

In an attempt to quantify the total contracting done in Arizona, we reviewed Dun and Bradstreet's *D & B Regional Business Directory* for the Phoenix and Tucson area. The 1998 edition contains 1996 financial data, including annual gross sales reported by establishments in Arizona. The total number of business locations in the SIC range (1521 – 1799) covering construction and contracting activity tracked by Dun and Bradstreet in their database for Arizona was 12,881, using each business location's primary SIC code. Of the total 12,881 tracked, only 2,696 business locations, or 20.93%, had detailed financial information that was included in the *Regional Business Directory* for 1998.

The 1996 annual sales value of these 2,696 establishments resulted in a total of over \$14 billion; however, this amount does not break out work done outside of the state which is reported in gross annual sales. We attempted to adjust for this by reviewing the average percentage of work done outside of Arizona by the top 25 commercial contractors, as shown in the *Business Journal's 1998 Top 25 Lists*. Roughly 84% of the work done by these contractors was done within Arizona. Using this adjustment, the D & B data resulted in a total of \$11.94 billion done by the 2,696 establishments reported in the 1998 edition.

In comparison the UofA/ADOR data showed \$11.1 billion in total contracting receipts for the same time period (See Table 1 under "D. Summary of Revenue Impact"). Therefore, we can conclude that at least roughly \$840 million in contracting is not being reflected by the UofA/ADOR data.

Limitations of D & B Data

First, the D & B data does not properly reflect work done in Arizona by out-of-state companies. Only Arizona establishments are reflected in the information and, therefore, out-of-state companies would have to have an office here to be considered an establishment by D & B. Second only 21% of all the establishments tracked by D & B were reported in the directory.

In addition, not all of the establishments in the directory reported their annual gross sales to D & B. Instead, a number of establishments withheld annual gross sales revenue. Therefore, this data, like the previous data, does not reflect the total contracting done in Arizona.

Estimate of High-End of Total Construction Done

Based on the limitations of this data, we estimated an upper end for total contracting done in Arizona by averaging the total reported by all 2,696 establishments and extrapolating that to the total population of 12,881. This results in over \$50 billion in total contracting.

4. Current Construction Report Data

Current Construction Report Data Detail

In a final attempt to quantify the total amount of contracting done in Arizona, we reviewed the U.S. Census Bureau's Current Construction Reports and F. W. Dodge's Regional Construction Award reports. The Census Bureau reports the value of construction put in place on a monthly basis for the entire United States. This includes all construction done excluding maintenance and repairs to existing structures or service facilities, the cost of installation of machinery and equipment, land and drilling of gas and oil wells. This time series is referred to as C30.

We then reviewed the C50 series in an attempt to determine the value of maintenance and repair work that was not reported in the C30 report. The Bureau of Census defines maintenance and repair work as "expenditures (that) represent current costs for incidental maintenance and repairs which keep a property in ordinary working condition rather than additional investment in the property... (and) includes expenses for painting, papering, floor sanding, furnace cleaning or adjustment, ... expenditures for plumbing, heating, (and) electrical work, (etc.)... (but) do(es) not include expenses for trash and snow removal, lawn maintenance, and landscaping, or cleaning and janitorial services." Under Arizona law, this maintenance and repair work would be included in contracting for tax purposes. The C50 reports, however, only reflect the maintenance and repair work done on residential buildings.

We then used F. W. Dodge's Regional Construction Award data to determine the Arizona percentage of total construction awards in the United States during Fiscal Years 1993 to 1998. F. W. Dodge tracks the construction bidding process in each state and determines the total value of construction contracts for the United States on a monthly basis.

Using this percentage, we estimated the total construction put in place and residential maintenance and repair for Arizona for the Fiscal Years 1993 to 1997. Fiscal Year 1998 was

then estimated based on the actual construction put in place and an estimate of the residential maintenance and repair expenditures, using the first quarter 1998 results as an estimate for second quarter 1998 expenditures. This resulted in the following estimates of total contracting done in Arizona:

Fiscal Year	Est. Construction Put In Place And Res. Maintenance & Repair in Arizona
1992	\$14.3 billion
1993	\$14.6 billion
1994	\$17.1 billion
1995	\$19.5 billion
1996	\$20.6 billion
1997	\$21.2 billion
1998	\$21.5 billion

(See Appendix F for calculations)

Limitation of Current Construction Report Data

The first limitation that exists for this data is that it is estimated based on a percentage. Second, no attempt is made to determine the value of the maintenance and repair work done on nonresidential buildings. Therefore, this data does not properly reflect the total contracting work done in Arizona; however, it can be used in determining an upper limitation.

5. Determination of an Upper Limitation for Total Contracting Done

Using the five data sources, we can determine what the most likely upper limitation is for the total contracting done in the state. The Census of Construction upper limitation for Fiscal Year 1998 was \$20.8 billion, the UofA/ADOR data has an estimated upper end of \$24.7 billion, and the Current Construction Report data has an estimate of \$21.5 billion. Considering that the estimate of the upper limit for the D & B data was substantially different than the other data, we excluded its \$50 billion upper limit.

Therefore, we can conclude that total contracting in Arizona is somewhere between \$20.8 billion and \$24.7 billion for Fiscal Year 1998. Using the median of this range, \$22.7 billion, we can assume that the Fiscal Year 1998 UofA/ADOR data we are using in the calculation understates the total contracting by \$9.8 billion, or by 43% (UofA/ADOR data shows \$12.9 billion for Fiscal Year 1998, see Table 1 under "D. Summary of Revenue Impact").

C. Further Considerations in the Calculation of the Revenue Impact

The following factors play a significant role in the quantification of the revenue impact:

- Costs for materials, components, and supplies
- Domestic, out-of-state, and foreign work

- Construction awards, actual billings, and construction work completed
- Nature and extent of noncompliance

As noted in the summary of the 1992 Census, the percentage of cost for materials, components and supplies over the last twenty years was very stable with only slight variation; therefore, it appears reasonable to assume that the weighted average of 41.3% correctly reflects the cost of materials for the revenue impact calculations.

In contracting, the tax is due in the area where the activity occurred and not where the materials may have been purchased. Therefore, it is important to quantify the amount of construction activity that occurred in Arizona. As shown above, we determined the upper boundary to be 45% more than what the UofA/ADOR data shows. We also applied this adjustment to our estimate.

Tax liability occurs upon recognition of income. The tax is reported when the income is accrued or received for the particular contracting activity. Therefore, we have to differentiate between total billings, construction awards and actual construction work completed. Again, total billings, construction awards, and construction completion data for the top 25 commercial contractors in Arizona were utilized to derive benchmarks for the important ratios of total billings/construction awards and total billings/construction completed. Over the four-year period from 1993 through 1996, new construction awards amounted to about 104% of total construction billings for the top 25 commercial contractors. In the same period, actually completed construction work comprised about 80% of total billings. Current tax collections are based on completed work whereas the proposed tax change would require an immediate taxation of materials purchased. Therefore, we multiplied total sales after deducting for labor as derived from the UofA/ADOR data by 1.25 (equals 100/80), to adjust for the timing delay impact.

1. Survey Results

The Business Journal's *The Top 25 Lists* were reviewed from 1995 through 1998. The lists for commercial building contractors, homebuilders, mechanical contractors, electrical contractors, highway-heavy contractors, masonry contractors, and telecommunications contractors were reviewed to compile a list of possible survey recipients. 220 Surveys were sent to contractors in Arizona.

As specified previously, there are 35,940 active registered contractors in Arizona. Of these, 18,792 have state transaction privilege tax licenses per the Arizona Department of Revenue. The survey represents 0.61% of the total active registered contractors or 1.17% of the total contractors that have state transaction privilege tax licenses.

80 of the contractors returned the survey; however, only 56 completed the questions, resulting in a 25.45% response rate. The gross receipts less deductions for these respondents accounted for a total of over \$1.65 billion or 20.66% of the total taxable contracting receipts for 1997. The average percentage of materials in relation to total taxable contracting receipts for the total survey was 31%, and 26% for labor. However, the weighted-average based on total dollars of taxable contracting receipts resulted in 46% for materials and 43% for labor. The average

number of days from the purchase of materials to payment of tax was 96.9 days for all respondents.

Although the survey did not use a random sample for its results, the weighted-average percentage of materials closely corresponds to the percentage determined using the other statistical data, and thereby reaffirms the results of the previous calculations.

Following is a table summarizing the survey data (Details can be found in Appendix C):

	Commercial	Electrical	General	Heavy and Highway Construction	Home-builders	Masonry	Mechanical	Tele-communications	Total
# of Respondents That Completed Questions	13	7	6	7	8	2	9	4	56
% Prime Contracting	90%	26%	73%	58%	100%	>1%	41%	53%	
% of Materials Purchased Out-of-State	2.7%	4%	4%	5%	8%	>1%	6%	31%	
% of Materials Purchased Under Agency	16.3%	14%	32%	5%	>1%	>1%	20%	1%	
Avg. # of Days	93.6	53.6	89.2	210	150	0	78.3	101.25	96.9
Total Taxable Receipts Reported (Thousands)	\$800,177	\$17,664	\$38,540	\$200,367	\$466,691	>\$1	\$87,654	\$43,731	\$1,654,925
% of Total Taxable Receipts Reported	48.4%	1%	2.33%	12.1%	28.2%	>0.01%	5.3%	2.64%	
Avg. % of Materials	38.3%	27%	21%	30%	37%	41%	31%	24%	31%
Weighted Avg. %	42.6%	26%	46%	49%	43%	41%	35%	18%	46%
Avg. % of Labor	9.7%	28%	19%	25%	40%	36%	36%	27%	26%
Weighted Avg. %	9.7%	54%	32%	29%	44%	36%	65%	61%	43%

2. Time-Value of Money Analysis

Based on the survey results, an average of 96.9 days elapsed from the time of purchase of materials to the beginning of a contract and payment of the current contracting TPT. Therefore, a present value calculation was done to determine the time-value of money based on the determination that the state would receive the tax earlier and, therefore, accrue interest on these funds during the 96.9 days.

The rate of return used was based on the yields from the State Treasurer's Local Government Investment Pool (LGIP) and Local Government Investment Pool-Government (LGIP-GOVT). On average these pools had a monthly return of 5.679% and 5.367% from July 1995 through September 1998. (See Appendix D for detail)

3. Determination of Noncompliance Under the New System

The next determination necessary is what level of noncompliance would exist under the new system. The new system would tax materials upon purchase and a corresponding use tax would apply to materials purchased out-of-state when incorporated in the project.

This is what California currently does. According to an analysis by the California Board of Equalization, the noncompliance occurring for material and fixtures on construction contracts was less than 5%. Therefore, we can assume that the noncompliance under the new system for Arizona would have a similar result for our modeling purposes.

D. Summary of Revenue Impact

In order to adjust for time trends we will present the calculations of the revenue impact for Fiscal Years 1993 through 1997. We will also present the predicted impact for Fiscal Year 1998 based on the linear time trend models. Table 1 below reflects current collections for comparison purposes. Tables 2 through 4 report the results for three different scenarios.

Table 1 – Current Tax Collections Determination (ADOR and UofA data)

Fiscal Year	Actual Tax Collections in \$ Million	Taxable Sales In \$ Billion	Total Sales Before The 35% Deduction in \$ Billion
1993	216.8	4.3	6.7
1994	270.2	5.4	8.3
1995	319.6	6.4	9.8
1996	362.3	7.2	11.1
1997	392.0	7.8	12.1
1998	418.2	8.4	12.9

1. The Most Likely Result

Scenario I shows the most likely result if the current tax on contractors is changed to a tax on materials. It uses the UofA/ADOR data as the base information (shown in Table 1). This data is then adjusted to reflect our determination of the total contracting done in the state based on our review of all the pertinently available data involving construction and contracting activity in Arizona (see B above, resulting in our determination of total contracting under B.5). New tax collections are calculated from this value by multiplying it by 41.3% to get the value of materials (as determined from the Census of Construction data under B.1 above). Then the 5% tax rate (the current state transaction privilege tax rate) is used, adjusting for the time value of money to reflect the timing difference for payment under the new system and adjusting for the determination of non-compliance under the new system. The revenue impact is determined by comparing the newly calculated tax collections to the current tax collections as shown in Table 1.

Table 2 – Scenario I

Fiscal Year	Total Value of Construction in \$ Billion *	“New” Tax Collections in \$ Million**	Revenue Impact In \$ Million ¹
1993	11.7	242.5	25.7
1994	14.7	302.2	32.0
1995	17.3	357.4	37.8
1996	19.6	405.2	42.9
1997	21.0	438.3	46.3
1998	22.7	467.8	49.6

¹ The time-value of money impact for FY 1998 is \$3.9 million.

Scenario I utilizes the UofA/ADOR data as the basis for the calculations, and determines the revenue impact based on the following assumptions:

- * The total value of construction for 1998 is the midpoint of the range of the analysis used in determining the total contracting done in the state (See B.5. under "Revenue Impact"). The values for the other years were obtained using linear interpolation methods.
- ** New tax collections were calculated under the following assumptions resulting in a range, of which the midpoint is shown:
 - A factor of 0.413 (41.3%) was applied for costs of materials, components, and supplies.
 - A tax rate of 0.05 (5%) was applied.
 - Based on the average elapsed time of 97 days, the time value of money was calculated using interest rates of 5.679% and 5.367%
 - Based on the noncompliance analysis for the old and the new systems, a factor of 1.05 was applied to adjust for the higher compliance under the new system (see C.3.).

Based on our analysis for 1998, the most likely result will be a \$49.6 million increase in revenue, which is less than the mid-point of the total range between the \$199.5 million gain (Scenario II) and the \$90.5 million loss (Scenario III). This impact, however, does not include any adjustment for litigation or enforcement costs savings that may occur from the proposed change (See Appendix E for data detail).

2. Determination of the Upper End of the Range

Scenario II determines the upper end of the possible range of the revenue impact if the current tax system on contractors is changed. It uses the Census of Construction data as its base information. This data is then adjusted to reflect the establishments omitted from the data (See B.1 above). From the known 1992 data, total values of construction for 1993 through 1998 are determined using mathematical modeling (linear interpolation). The new tax collections are calculated in the same manner as in Scenario I. The revenue impact is the difference between the current tax collections as shown in Table 1 and the new tax collections determined by Scenario II.

Table 3 – Scenario II

Fiscal Year	Total Value of Construction in \$ Billion *	"New" Tax Collections in \$ Million**	Revenue Impact In \$ Million ²
1993	15.3	320.2	103.4
1994	19.0	399.2	129.0
1995	22.6	472.0	152.4
1996	25.6	535.0	172.7
1997	27.6	579.0	187.0
1998	29.6	617.7	199.5

² The time-value of money impact for FY 1998 is \$15.7 million.

Scenario II is the upper limit calculation utilizing the Census of Construction data and making the following assumptions:

- The total value of construction for Fiscal Year 1993 is the linear interpolation based on the number of establishments omitted in the Census of Construction data for the calendar year 1992. The values for the other years were obtained using similar linear interpolation methods as Scenario I.
- ** New tax collections were then calculated under the same assumptions as Scenario I above resulting in a range, of which the midpoint was reported.

3. Determination of the Bottom End of the Range

Scenario III is the calculation of the bottom end of the revenue impact range. The UofA/ADOR data are used as the base information, assuming that the current tax system truly reflects all contracting activity done within the state. This data is then adjusted to reflect billings versus total construction contracts completed (See fourth paragraph under C.) and the value of in-state work, as determined by the top 25 commercial contractors in the Business Journal's 1998 Top 25 Lists. New tax collections are then determined using the resulting range in the same manner as Scenario I. The revenue impact is then determined by comparing the midpoint determination of the new tax collection range and comparing it to the actual collections as shown in Table 1.

Table 4 - Scenario III

Fiscal Year	Range after Adjustments In \$ Billion *	"New" Tax Collections in \$ Million**	Revenue Impact In \$ Million*** ³
1993	6.7 – 7.9	158.2 – 171.8	(46.9)
1994	8.3 – 9.9	197.2 – 214.1	(58.5)
1995	9.8 – 11.7	233.2 – 253.2	(69.1)
1996	11.1 – 13.2	264.4 – 287.0	(78.4)
1997	12.1 – 14.3	286.1 – 310.6	(84.8)
1998	12.9 – 15.3	305.2 – 331.3	(90.5)

Scenario III utilizes UofA/ADOR data as the base data for the calculation and derives a range for new tax collections based on the assumptions listed below:

- * The adjustments include the factor 1.25 for total billings over construction awards completed and the lower 0.8 (80%) and upper limit 0.95 (95%) for the quantification of in state work.
- ** New tax collections were then calculated under the same assumptions as Scenario I above resulting in a range, of which the midpoint was reported.
- *** The revenue impact is the midpoint of the range derived compared with the actual collections shown in Table 1.

³ The time-value of money impact for FY 1998 is \$7.1 million.

ANALYSIS OF LITIGATION COSTS

Taxpayers that responded to our survey indicated that the cost of administering this tax on an annual basis, which could be eliminated with a tax on materials, ranged from \$40,000 to \$100,000.

Because of the complexity of the tax, however, there are numerous other costs if there is tax enforcement activity (i.e. audit) as outlined below.

A. Audit and Appeal Process

Under the current state transaction privilege and use tax system, the Arizona Department of Revenue (ADOR) can conduct an audit of any taxpayer to determine whether tax was properly reported. The auditor reviews the books and records to determine the correct amount of tax, and in most cases, provides the taxpayer with a tentative assessment determination. After discussing the basis of the tentative determination and upon completion of the audit, the state auditor will issue a "Notice of Proposed Assessment," if there is any difference between the tax reported and the amount calculated by the auditor.

The taxpayer has forty-five days after receiving the Notice to decide whether to appeal the decision. If the forty-five days expire without appeal, the proposed assessment becomes final.

If the taxpayer disagrees with the assessment and wishes to appeal the decision, a protest must be filed in writing stating the reasons the taxpayer believes the assessment is wrong and how the tax, interest and penalties should be reduced. If the protest is filed in a timely manner, the collection process is halted; however, the taxpayer is responsible for any tax, penalty and interest that is not protested. Compounded interest also accrues during the calendar year on the protested amount, if it is ultimately determined to be correct.

The taxpayer has the option to choose an informal conference or a formal hearing in the first step of the appeal process. An informal hearing is between the taxpayer, the auditor and the auditor's supervisor. If the taxpayer is not satisfied, a request for a formal hearing can be made.

The State Office of Administrative Hearings (OAH) conducts formal hearings for cases involving state transaction privilege and use tax. After a request for a hearing, the taxpayer will be given a minimum of twenty days written notice of the date, time and location of the formal hearing.

During the OAH hearing, a taxpayer can attend the hearing in person, by phone, or may request that the protest be resolved through written memoranda. An attorney is not required for the hearing, and all information is presented to the hearing officer or administrative law judge, who will issue a written decision generally within ninety days after the close of the hearing record.

A taxpayer has the right to be represented by an attorney, CPA or anyone else during the administrative process and may be reimbursed for reasonable fees and costs incurred during the process, if a ruling is made in the taxpayer's favor and if ADOR was not substantially justified in

its position. A request for reimbursement must be made within thirty days after the conclusion of the process and may not exceed the lesser of \$20,000 or the actual amount spent on representation.

If the taxpayer disagrees with the hearing officer's decision, an appeal can be made to the Director of ADOR, the State Board of Tax Appeals (BOTA), or Tax Court within thirty days of the decision.

If the taxpayer does not request a review by the Director, the hearing officer's decision becomes the final order of ADOR. In a review, the taxpayer and ADOR's Audit Section submit arguments in writing to the Director. The Director usually issues a decision within ninety days after the hearing record is closed. Within thirty days, the taxpayer can appeal this decision to either BOTA or Tax Court. A Tax Court appeal can also be filed within thirty days of the final BOTA decision.

B. Taxpayer Costs

Besides the costs associated with the employees of a taxpayer being involved during the audit process, the taxpayer will also have costs associated with hiring legal counsel for complex state TPT issues.

We have estimated litigation costs for a taxpayer to bring an appeal involving state transaction privilege tax issues through the Court of Appeals at \$60,000 per case, on average, assuming that only one administrative appeal occurs (only OAH, no Director review and no BOTA). If the case is complex or if the case goes to trial and expert witnesses need to be used, the attorneys estimated the cost would increase from \$10 - \$20,000. The estimate can be increased another \$5,000 per case, if a Petition for Review with the Arizona Supreme Court is requested. This could increase another \$5 - \$10,000 if additional briefs need to be filed at the Supreme Court Level. Some of these costs may be reimbursed by the State if the taxpayer prevails; however, the statutory limitations preclude full reimbursement of these costs and the maximum would be \$20,000.

C. State Enforcement and Appeal Costs

In addition to taxpayer costs, the state incurs costs for enforcement and litigation of contracting issues. The Arizona Department of Revenue incurs costs for auditing, while the Attorney General's Office incurs costs for litigation. In addition, the Office of Administrative Hearings, the Board of Tax Appeals, Tax Court, the Court of Appeals and, occasionally, the Supreme Court, all have expenditures related to the litigation of contracting cases. Unfortunately, not all of these entities have costs broken down specifically to contracting cases, and therefore we were not able to determine a comparable per case cost basis to the taxpayer costs.

Although, not all of these state costs would necessarily be eliminated if the law were changed, we can assume that at least some of the costs would be mitigated by a change in statute which would simplify the collection of the tax. We can also assume that due to the complexity of the issues involved, substantial time and money is spent on state enforcement and litigation for this tax.

Appendix A

APPENDIX A - STATE TAXATION OF CONTRACTORS AND MATERIALS

The following chart describes each state's treatment of contractors and materials for state sales tax purposes. Of the 50 states, five have no general state sales tax. Three states tax only the contractor, two tax both the contractor and materials, three tax construction labor to some extent, and one taxes the value of the contract. 36 states, or 80% of those with state general sales tax, tax construction materials, instead of the contractor. (As of 12/1/98)

State	Tax on Contractors	Tax on Materials	Explanation
Alabama		4%	
Alaska	No state sales tax		
Arizona	5%		Applies to prime contractors only. A 35% in lieu labor deduction exists.
Arkansas		4.5%	
California		5.5%	
Colorado		3%	
Connecticut	6%	6%	Contractors are considered consumers of materials and materials are subject to tax. In addition, contractor services to real property provided to commercial, industrial, or income-producing real property are subject to tax. Gross receipts from paving, painting, staining, wallpapering, roofing, siding, and exterior sheet metal work provided in the renovation and repair of residential real property are also subject to tax.
Delaware	No state sales tax		Contractors are subject to a business licensee fee annually of \$75 plus 0.65% of taxable gross receipts reduced by payments to subcontractors in excess of \$12,000 per month plus a 10% surtax minus a \$30 monthly credit.
Florida		6%	Subject to provisions in Revenue Department Rule 12A-1.051, F.A.C.
Georgia		4%	
Hawaii	4%	0.5% & 4%	0.5% for sales at wholesale and 4% for sales at retail.
Idaho		5%	
Illinois		6.25%	
Indiana		5%	
Iowa		5%	
Kansas	See Note	4.9% *	Sales tax applies to taxable services performed for others, including taxable services performed for other contractors. The taxable base for all contracts involving the application or installation of tangible personal property shall be the difference between the contract price and the cost of material, supplies, and

State	Tax on Contractors	Tax on Materials	Explanation
			payments to subcontractors, including sales or compensating tax paid by the contractor on these items. The service of installing or applying tangible personal property in connection with the original construction, which is the first or initial construction of a new building or facility is not subject to tax. See Kansas Reg. 92-19-66b for further guidance regarding taxable labor services and what original construction includes.
Kentucky		6%	
Louisiana		4%	
Maine		6%	
Maryland		5%	
Massachusetts		5%	
Michigan		4%	
Minnesota		6.5%	
Mississippi	3.5%		Only applies to commercial contracts in excess of \$10,000. The contractor pays the tax and then is allowed to purchase component materials tax-free. Retail tax applies to residential construction and contracts of \$10,000 or less for material only at 7% unless the labor rendered is a taxable service.
Missouri		4.225%	Consumers pay tax to suppliers.
Montana	No state sales tax		
Nebraska		5%	
Nevada		6.5%	
New Hampshire	No general state sales tax		
New Jersey		7%	
New Mexico	5%		Materials are deductible if a Type 6 Nontaxable Transaction Certificate is issued.
New York		4%	
North Carolina		4%	
North Dakota		5%	Materials used by contractors are subject to a 5% use tax.
Ohio		5%	Component materials of structures owned by governments, churches or non-profit charitable organizations are not subject to tax.
Oklahoma		4.5%	Contractors may make exempt purchases on behalf of an exempt entity (Oklahoma counties, cities, public school districts, institutions of higher education and the Grand River Dam Authority).
Oregon	No general state sales tax		

State	Tax on Contractors	Tax on Materials	Explanation
Pennsylvania		6%	
Rhode Island		7%	
South Carolina		5%	
South Dakota	See Note	4%	Contractors are subject to a 2% excise tax if the contract is to improve real property.
Tennessee		6%	
Texas	See Note	6.25%	Labor for new construction or improvements to residential real property is nontaxable; however, the contractor is still liable for tax on supplies and equipment used, including, in the case of a lump-sum contract, the materials incorporated into the property. Generally, all labor performed for repair or remodeling of nonresidential or commercial real property, for repair of tangible personal property and any real property services, such as janitorial services, is taxable. See Texas Regulation, 34 TAC Section 3.291 for details regarding contractors, taxable materials and taxable services.
Utah		5%	
Vermont		5%	
Virginia		4.25%	
Washington	Exempt – See Note	0%	Value of the contract is subject to the retail sales tax.
West Virginia		6%	
Wisconsin		5%	Real property construction only.
Wyoming		3%	
Washington D.C.		6%	

Appendix B

APPENDIX B - HISTORY

Since the inception of the state's transaction privilege tax, the contracting classification has been altered through court interpretations and statutory changes. Following is a synopsis of the evolution of the tax in Arizona.

On April 30, 1933, the first Arizona Transaction Privilege Tax became effective (Chapter 90, Laws 1933). The tax was levied on the gross proceeds of businesses at varying rates and contracting was not specifically mentioned. On July 1, 1933, this tax was altered by Laws 1933, 1st Special Session, Chapter 17, which changed the distribution of tax and created a delinquency date. This tax expired on March 1, 1935. Effective May 1, 1935, the tax was reenacted and several new categories of business were added. The rates were also changed. Again, contracting specifically was not mentioned.

In 1937, the Arizona Supreme Court held that the privilege tax on retail sales applied to a contractor's proceeds from contracting, in *Moore v. Pleasant Hasler Construction Co.*, 50 Ariz. 317, 72 P.2d 573. Upon rehearing (51 Ariz. 40, 76 P.2d 225), the Court determined that the tax did not apply to contracting. The contractor received proceeds from a lump sum contract to build two bridges for the state. It protested the application of the tax on its activity. The Court tried to determine whether a contractor who furnishes materials for construction of a project consumes or sells the materials. If it consumed them, then it would not be taxed since the tax was on the seller. The Court concluded that the contractor was the seller and not the consumer. It further determined that the language in the statute was very broad and put "a tax upon practically every business activity in the state." There was a dissenting opinion, that pointed out that the tax applied only to specified activities, and contracting was not listed. The dissent also determined that the general rule of statutory construction as it related to words and phrases was ignored by the court and that a bridge, which is realty, cannot be considered tangible personal property. Before the first hearing in this case, the Legislature enacted a privilege tax on contracting on June 11, 1937 (Laws 1937, 1st Special Session, Chapter 2). Upon rehearing, the court stated that since the tax was imposed upon contractors in 1937, the original act in 1933 must not have been designed to tax contractors as retailers of tangible personal property.

In 1943, a Superior Court judgment held that sales of material to a contractor were taxable retail sales whether or not they were incorporated into a structure. In response, the Legislature enacted Laws 1943, Chapter 16, which prohibited any excise or sales tax on materials sold to a contractor and incorporated into work constructed under contract. The Governor originally vetoed the act; however, the Legislature overrode the veto. It was, subsequently, declared unconstitutional by the Arizona Supreme Court in *Martin v. Moore*, 61 Ariz. 92, 143 P.2d 334, 335. The Supreme Court held it violated Article III of the constitution by declaring the meaning of existing law and usurping the function of the court.

In *Crane Co. v. Arizona State Tax Commission*, 63 Ariz. 426, 163 P.2d 656 (1944) the Supreme Court held that a taxpayer's sales to contractors were nontaxable resales. The Court relied on its decisions in *Moore v. Pleasant Hasler* and noted that the first hearing held that contractors sell the materials they incorporate into a structure and found nothing contrary to that decision upon rehearing the case. The court determined that contractors were not the ultimate consumers and that their purchase and placement of materials in structures constituted a resale of the property. Thus, it was a

resale when a merchant sold tangible personal property to a contractor, which was incorporated into the construction under the contract.

In *Arizona Tax Commission v. Frank Harmonson Company Metal Products*, 63 Ariz. 452, 163 P.2d 667 (1945), the Supreme Court determined that sales by a contractor to the federal government were not exempt from tax because the taxpayer was taxable under the contracting category. In this case, a contractor sought to stop the Commission from collecting tax on its federal defense contracts based on a regulation exempting such contracts, which was in force during the audit period. The Court determined that the Commission could not exempt a taxpayer unless the legislature specifically granted it the authority to do so. The Court also found that the contracts did not qualify for the exemption for sales to the federal government. The statutory language for the contracting classification taxed the gross proceeds or gross income of the business and "may or may not include sales." Relying on *Crane*, the court determined that, if a contractor sells, it is incidental to his business; therefore, it was not a tax on sales and did not qualify for the exemption.

Under *Duhame v. State Tax Commission*, 65 Ariz. 268, 179 P.2d 252 (1947), the Court reaffirmed its decision that contractors were taxable on their receipts from a contract with the federal government because contractors do not sell the materials they incorporate into a project. Thus, the activity could not qualify for exemption as sales to the federal government. The Court stated, "...By definition in this Act, a contractor when fabricating personalty into realty neither sells, resells, sells at retail, nor can be considered a retailer." In effect the Court overruled *Crane* to the extent it held that contractors are selling tangible personal property to the contractee in fabricating personalty into realty and reaffirmed the second *Pleasant Hasler* decision.

The Supreme Court in *Smotkin v. Peterson*, 73 Ariz. 1, 236 P.2d 743 (1951), held that a taxpayer who contested its classification as a contractor could only do so by first paying the tax under protest.

In 1952, the state Legislature enacted Laws 1952, Chapter 100, which exempted the sales of materials to licensed contractors from the transaction privilege tax, if the materials were incorporated or fabricated into any structure, project, development or improvement in fulfillment of a contract.

In 1953, The Arizona Supreme Court held that a contractor was liable for privilege tax on its purchases under *Johnson v. Crane Co.*, 75 Ariz. 156, 253 P.2d 341. A contractor refused to pay the tax on plumbing supplies it had purchased to complete contracts, stating they were sales for resale. The purchases in question had been made before the change in law in 1952 became effective. The court cited *Duhame* and said that the sale was not a resale and that selling to a contractor was a retail sale. The court also refused to distinguish between sales to subcontractors and general contractors.

The Arizona Legislature changed the taxation scope in 1954, by establishing exemptions for service occupations and creating a labor deduction for contracting. In statute the tax became 1% of gross proceeds of sales or gross income from contracting and stated, "...Payments made by the contractor for labor employed in construction, improvements or repairs shall not be subject to the tax herein imposed." This was incorporated into the revision and recodification of the laws of the state in 1956 (Under Laws 1955, Third Special Session, Chapter 3), which created the Arizona Revised Statutes and placed the state transaction privilege tax in Title 42.

During the recodification process, the Court continued to review contracting. In *Moore v. Smotkin*, 79 Ariz. 77, 283 P.2d 1029 (Rehearing 79 Ariz. 401, 291 P.2d 216) (1955), the Court held that developers of homes were not taxable as contractors where they had not first contracted with others to build the homes. The Court determined that they were not taxable as contractors because they had not entered into a contractual agreement to build any structure. Even though the taxpayers did in some cases enter into a sale agreement before completion of a home, the agreement did not contain a promise to build a structure and, thus, was not considered contracting by the Court. The Court went further, stating that contracting does not include owners who construct buildings on their own property. This decision was reaffirmed in *Arizona State Tax Commission v. Staggs Realty Corp.*, 85 Ariz. 294, 337 P.2d 281 (1959).

The Court dealt with what was deductible concerning labor costs under the law in 1967 with the case of *J.H. Welsh & Son Construction Company v. Arizona State Tax Commission*, 102 Ariz. 443, 432 P.2d 455. In this case, the Court determined that a contractor's contributions to industry funds were not deductible under the labor deduction. The contractor had attempted to deduct contributions to an industry promotion fund and an apprenticeship fund. The Court stated that these amounts were not payments for labor employed in construction under statute, because they were not paid directly to the workers.

In 1968, the Court of Appeals addressed the taxation of a contractor by a city. The decision, in *Ashton Company v. City of Tucson*, 7 Ariz. App. 509, 441 P.2d 275, held that a city was not allowed to impose its tax on a contractor working for the University of Arizona. The Court determined that the contractor would pass the tax on to the university and thus, upon the state thereby placing a tax on another governmental entity.

The Supreme Court dealt with another contracting issue in 1969. In *Ebasco Services, Inc. v. State Tax Commission*, 105 Ariz. 94, 459 P.2d 719, the Court determined that a contractor was not subject to tax on owner-supplied materials or income attributable to non-contracting services. In the first instance, the taxpayer purchased equipment for the contract in the name of the contractee, under an agency agreement. The State Tax Commission argued that the equipment constituted gross receipts to the taxpayer because the purchasing agency was in substance a financing arrangement and terminated at the point of purchase, causing the equipment to belong to the taxpayer before being supplied under the contract. The Court determined that this was erroneous; no change of ownership had occurred and the Court would not create a legal fiction in order to tax the transaction. The Commission also argued that the taxpayer had realized constructive gross proceeds by providing the equipment for the contract, but the court found no support for this argument either. It determined that there is no contractual obligation for a contractor to supply the materials in a contract. The Court rejected the last argument made by the Commission that the meaning of gross receipts was much broader and included the purchase of the equipment. Instead, the Court determined that gross receipts was inadequately defined in law and that an ambiguous statute must be interpreted in favor of the taxpayer. The Court would not extend the application of the tax to apply to something that was not specifically covered in statute. The Court looked to the definition of contractor and determined that the engineering and design functions did not fall into any of the categories affecting contracting or builders. Finally, the Court addressed the labor deduction and determined that wages paid to security employees was not deductible under law, finding that "every interpretation shall be against

exemptions from taxation...” *Ebasco* was the first case to address the impact of the use of an agency agreement on the contracting tax base.

In *State Tax Commission v. Howard P. Foley Co.*, 13 Ariz. App. 85, 474 P.2d 444 (1970), the Court of Appeals held that a joint venture that built a power line was engaged in contracting. The activity was not considered an exempt interstate sale, nor was it a casual activity. The Court determined that it was not a sale due to the elements of the contract and what the parties had labeled themselves. The Court also found that the taxpayer had not constructed, manufactured or built component parts and then sold them. Instead, it had purchased the components for third parties to construct and build a transmission line and substation. The Court also rejected the notion that the nature of the materials was interstate because it determined that the materials had arrived in Arizona for use here and therefore, lost any interstate character. Finally, the Court dismissed the casual transaction exemption because the sole purpose of the joint venture was the project itself.

In 1971, the Court of Appeals overturned *Ashton* with *City of Tempe v. Del E. Webb Corporation*, 14 Ariz. App. 228, 482 P.2d 477. A contractor in this case protested a city’s tax on its proceeds from a construction contract with the Arizona Board of Regents for work on a university campus. The Court determined that it did not matter that the financial burden of the tax fell on the state. The Court held that this decision was prospective in view of the overruling of *Ashton*; resulting in uneven treatment of taxpayers.

A federal court ruling in *Lusk Corporation v. Arizona State Tax Commission*, 462 F.2d 187 (9th Cir. 1972), determined that the activity of platting residential subdivisions and constructing off-site improvements before a sale constituted contracting. This case arose through a bankruptcy proceeding involving privilege tax liability of a corporate debtor. The taxpayer platted residential subdivisions on the land it purchased and constructed streets, sidewalks and sewer lines before offering the lots for sale. The taxpayer claimed it was not contracting because it was not engaged in the business of building homes. Instead, this was done by a wholly owned subsidiary of the taxpayer pursuant to contracts between it and the purchaser of the lots. The Court, however, determined it was contracting based on the definition of a contractor in statute. The definition included anyone who built any project, development or improvement. The off-site improvements were considered essential to the intended use of the property. The taxpayer was considered a contractor for both the house construction and the lot improvement.

1976 saw both a statutory change and a court case. Laws 1976, Chapter 49 exempted the sales price of land from the contracting classification to the extent it did not exceed fair market value. The Court ruled in *State Tax Commission v. Holmes & Narver*, 113 Ariz. 165, 548 P.2d 1162, that engineering and design services contained in the same contract with contracting were not subject to tax as contracting. The Court determined that, when it can readily be determined which portion of the business is from nontaxable professional services, the amount of the service is not inconsequential to the total business and the services are not incidental to the contracting business, they are not taxable. Thus, a single contract in which the parties contemplate keeping separate detailed accounting of the services will not result in the receipts for the services being taxed. *Holmes & Narver* further clarified the exclusion of nontaxable services first articulated in *Ebasco*, where there were two separate contracts for the engineering and the contracting.

In *Department of Revenue v. Hane Construction*, 115 Ariz. 243, 564 P.2d 932 (1977), it was determined that a contractor working on an Indian reservation under a Bureau of Indian Affairs contract was subject to state taxation. Since federal regulations recognized the tax and it was not imposed on Indians or their property, it was taxable contracting. The Court also dismissed the argument that the reservation was removed from the state's jurisdiction. The same year a ruling in *State Tax Commission v. Anderson Development Corporation*, 117 Ariz. 555, 574 P.2d 43 (App. 1977), held that a contractor doing mining work for a mine operator qualified for the use tax exemption for equipment used in mining (A.R.S. Section 42-1409.B.2). In this case the taxpayer removed waste rock, overburden and copper oxide ore. It also dug, hauled and dumped the ore in piles for the leaching process. It had purchased equipment to do the work without paying either sales or use tax. The Court rejected the argument that the use tax exemptions for mining equipment were not available to taxpayers not normally engaged in mining activity because there was no language or legislative intent indicating this. Since the equipment was used in mining activities, the taxpayer was entitled to the use tax exemption.

The contracting tax structure was significantly changed in 1978 with Laws 1978, Chapter 97. The Legislature amended the state transaction privilege tax statutes adding the definition of owner-builder and prime contractor. The legislation also exempted subcontractors from tax if they could demonstrate that the job was within the control of the prime contractor, and that the prime contractor was liable for the tax. Thus, the tax became one upon prime contracting only, instead of just contracting. The deduction for labor also was changed to a flat deduction of 35% of the gross income or gross proceeds in lieu of a labor deduction. The definition for prime contractor became "the contractor who supervises, performs or coordinates the construction, alteration, repair, ... including the contracting, if any, with any subcontractors or specialty contractors and is responsible for the completion of the contract. Owner-builder was defined as "a person who owns or leases real property within the state, and who acts as a contractor, either himself or through others, in constructing any improvement to real property, which real property as improved is held by such person for his use or for rental purposes." The legislation required prime contractors to provide a written statement to the purchaser for separately stating the additional charge for tax. Finally, the legislation stated that an owner-builder which sells its property within 24 months after the improvement is substantially complete would be treated as a prime contractor.

A Court of Appeals decision in 1979, *Dennis Development v. Department of Revenue*, 122 Ariz. 465, 595 P.2d 1010, held that the sale of land was not contracting and that land transferred in connection with contracting was not subject to tax. The Department of Revenue had relied on a 1960 regulation that denied a land deduction, and the taxpayer maintained that the legislative change in 1976 allowing the deduction was a clarification of existing law. The Court determined that the question was whether or not the sale of land was included within the taxation of contracting. It determined that the tax base does not include proceeds from the sale of land because it is not the result of the activity listed in law for contracting.

In Laws 1981, Chapter 110, the Legislature eliminated the requirement that a contractor be licensed by the Registrar of Contractors to qualify for the exemption of tangible personal property purchased to be incorporated into any structure, project, development or improvement in fulfillment of a contract. Also in 1981, Chapter 321 included the state and any of its political subdivisions, except

school districts, under the definition of person or company for state transaction privilege tax purposes.

In 1982, the Legislature exempted the sales and installation of groundwater measuring devices required under state law from the prime contracting classification and from the state transaction privilege tax in Laws 1982, Chapter 186. There were also two court cases involving contracting.

Knoell Bros. Construction v. Department of Revenue, 132 Ariz. 169, 644 P.2d 905 (App. 1982), held that the value of land transferred by a contractor could not be included in gross proceeds for the purposes of the 35% in lieu deduction for labor enacted in 1979. The court relied on *Dennis Development*, which determined that the sale of real estate was not contracting and thus could not be included in gross receipts for tax or for the in lieu labor deduction.

Lincoln Property Company v. City of Tucson, 131 Ariz. 473, 641 P.2d 1317 (App. 1982), held that a speculative builder was a contractor under the city ordinance and that it could not deduct certain reimbursed expenses related to non-contracting activity. The taxpayer developed land with limited partnership funds. It then improved the land, transferred it to the partnership and received reimbursement for all costs it incurred in development. Some of the costs were non-contracting activity, such as financing, advertising and design. The Court determined that a speculative builder fell under the definition of contractor in the official regulations of the city. Also the regulations denied a deduction for the cost of services. The Court ruled that the regulation applied to the taxpayer because the regulation had been passed and adopted by reference and was, therefore, a part of the ordinance.

Three judicial decisions involving contracting occurred in 1983. The first was *Arizona Department of Revenue v. Chastain Builders, Inc.*, 137 Ariz. 240, 669 P.2d 1017 (App. 1983). In this case the Court ruled that payments to material suppliers were not deductible under former law allowing contractors a deduction for payments to subcontractors. The taxpayer built and sold homes and wanted to deduct amounts paid to their suppliers of materials who were not contractors, but who held contractor and sales tax licenses. The taxpayer relied on a rule allowing amounts paid to a subcontractor which is duly licensed and holds a privilege tax license to be deducted. The Court determined that the material suppliers were not subcontractors or contractors because the definition of a contractor required the individual or company to provide labor, which these suppliers had not done.

Bassett v. City of Tucson, 137 Ariz. 199, 669 P.2d 976 (App. 1983) held that an owner was liable under the owner-builder provision of the city privilege tax on the sale of a shopping center. In this case the taxpayer owned real property and paid contractors to build a shopping center. The contractors' gross receipts were taxable, and, when the taxpayer attempted to sell the shopping center a year later, the city assessed it as an owner-builder on the gross receipts of the sale, less certain exclusions and credits. The taxpayer protested on the basis that it was merely an owner, not an owner-builder, and that the tax was double taxation. The Court rejected the mere owner argument because the taxpayer conceded that an owner-builder included every owner that improved property. Also the double taxation argument was rejected because the Tucson code provided a credit for tax paid previously by prime contractors for the improvements and thus contemplated a second level of taxation, but avoided a type of double taxation.

City of Phoenix v. Bentley-Dille Gradall Rentals, Inc., 136 Ariz. 289, 665 P.2d 1011 (1983) determined that providing machinery with operators was not taxable under the rental classification, but was under the contracting classification. The taxpayer argued that its activity was contracting and taxable in the jurisdiction where the work was done and the city argued that it was rental activity taxable in the city where the rental company was located. The Court relied on *State Tax Commission v. Peck*, 106 Ariz. 394, 476 P.2d 849 (1970), to determine the meaning of rental or leasing, since neither the city's code or regulations defined the meaning of the terms. It also used *State v. Steel City Crane Rental, Inc.*, 345 So.2d 1371 (Ala. App. 1977) to determine whether the activity was renting. *Steel City Crane* required that renting or leasing required giving up control of the property to the lessee. In this case the lessee did not control the property, instead the lessee coordinated the efforts of the operators and the machinery. Thus, the activity was not renting under transaction privilege tax.

In 1984, the courts addressed whether owners who sold property, where they had hired others to improve it were contractors under the City of Phoenix privilege tax code. In *City of Phoenix v. Santa Anita Development*, 141 Ariz. 179, 685 P.2d 1331 (App. 1984), the Court of Appeals ruled that the taxpayer was not a contractor because it had not received contracting receipts. The Court looked at the city's definition of contractor and determined that the taxpayer had sold improved properties but that the proceeds received from the activity were not the result of contracting. The city code did not include development activity in its definition. The Court reviewed its decision in *Bassett* and determined that the city of Tucson definition of contractor was different because its code stated that the definition applied without regard to whether the contractor was attempting to complete a contract.

The Legislature also clarified the owner-builder provision in 1984, with Laws 1984, Chapter 152. The clarification related to the treatment of an owner-builder as a prime contractor when it sells the real property as improved on or before the expiration of 24 months after completion of the improvements. The legislation made it clear that only the value of the improvements incorporated within the 24-month period would be treated as prime contracting.

The Legislature combined the various tax categories into one Consolidated Transaction Privilege Tax with Laws 1985, Chapter 298. This created Section 42-1308 for the prime contracting and dealership of manufactured buildings classification, while the owner-builder provisions were incorporated into a separate classification under Section 42-1307.

In *Kitchell Contractors v. City of Phoenix*, 151 Ariz. 139, 726 P.2d 236 (App. 1986), the Court of Appeals determined that a contractor's receipts from sales of material directly to a hospital were not subject to city tax as contracting. In this case, the contract had separate provisions for the sale of the materials and acting as construction manager. The contractor computed its contracting receipts after deducting the sale of the materials and, then included the sale receipts in its calculation of the 35% labor deduction. The city assessed all the receipts as contracting income. The Court determined that the separation of the contract into two separate components entitled the sale of materials to the exemption for sales to hospitals; however, the labor deduction was limited to the gross income from the contracting portion of the business (per *Knoell Bros. and Dennis Development*).

In *Gosnell Development Corporation v. Arizona Department of Revenue*, 154 Ariz. 539, 744 P.2d 451 (App. 1987), the Court ruled that it was a denial of equal protection to refuse to refund correctly calculated and paid transaction privilege tax to a taxpayer, when it was the Department's policy not to

assess other identical taxpayers who had not paid the same tax. The taxpayer was a contractor who built and sold resorts and homes. It properly calculated the 35% in lieu labor deduction after eliminating the underlying land value, while many of its competitors did not. Instead, they included the land value in the computation. Under the *Knoell Bros.* decision, it was determined that the land must be excluded for purposes of determining the 35% deduction; however, the trial court held that the decision should be prospective only. The Department then excused all the contractors who had improperly calculated the tax during the period up to the decision of the court. Those who had paid correctly were then treated differently. Under well-established law, the Court determined that this violated the rights of the taxpayer to equal protection under the law and that the taxpayer was unconstitutionally discriminated against.

In 1988, the Legislature recodified the state transaction privilege tax statutes into appropriate classifications in an effort to provide greater clarity. Effective July 1, 1989, Laws 1988, Chapter 161 created the prime contracting classification under Section 42-1310.17. This included the dealership of manufactured buildings in the prime contracting classification. The owner-builder sales classification was also created and placed in a separate section from prime contracting. The legislative intent of these changes was to reorganize the statutes without making any substantive changes to the previous statutory language.

The next major court case involving contracting occurred in 1990. The Court of Appeals held that reclamation work done for a mining company on an Indian reservation was prime contracting and not subcontracting or equipment leasing in *Granite Construction Co. v. State of Arizona*, 168 Ariz. 93, 811 P.2d 345 (App.). The Court also determined that the tax was not preempted by federal legislation. The taxpayer did reclamation work for Peabody Coal Company, which involved replacing soil and rock that had been removed in the mining process. The Court first rejected the argument of federal preemption because it found nothing that would indicate that the tax would lessen the amount received by the Navajos or the Hopis under the leases with Peabody. The Court then determined that the activity was prime contracting because the work it performed fell within the ordinary meaning of contracting under the statutory language. The Court rejected the argument that the company was merely leasing equipment because the taxpayer provided supervisory personnel to assist in the planning and supervising of the reclamation work. Also, the Court found that the taxpayer maintained substantial control of its equipment during the process in the same manner as the *Bentley Dille Gradall Rentals* case. Finally, the Court rejected the taxpayer's argument that it was a subcontractor because nothing Peabody Coal did fell into the statutory definition of contracting, and the taxpayer had failed to show that Peabody was liable for tax on the gross income attributed to the job for which they were paid.

In 1991, the Court determined that a partner in several partnerships acted as an owner-builder and not as a construction contractor in overseeing construction on the partnership's land. In *The Indigo Co. v. City of Tucson*, 166 Ariz. 659, 804 P.2d 129 (App.), the taxpayer had entered into several development partnerships with third parties to develop real property. It acted as managing partner, preparing development plans for commercial buildings, obtaining financing for the projects and undertaking day-to-day management of the completed buildings. The city then assessed the taxpayer under its construction contractor category. The Court held that the taxpayer was not taxable under this category because it had not entered into construction contracts with the partnerships nor had its status as a partnership establish that it built improvements on the partnership's land as their prime

contractor. The Court determined that the taxpayer was an owner-builder because, as a partner, it was an owner performing improvements to real property. The Court rejected the city's allegation that the materials were purchased tax free and stated that any partnership that retained improved property for 24 months after substantial completion would not be liable for the owner-builder tax.

Another significant decision on contracting in this year clarified the imposition of the tax under the owner-builder provisions. The Court of Appeals held that, in order to be liable for the tax, the owner of the property had to engage in activity where it was acting as a prime contractor instead of merely holding property as it was developed (*SDC Management Inc. v. Arizona Department of Revenue*, 167 Ariz. 491, 808 P.2d 1243, 1249 (App. 1991)).

Laws 1991, Chapter 290 clarified the responsibility for state transaction privilege tax under prime contracting. It allowed a contractor to exclude the gross proceeds from a contract if the person who hired the contractor provided a certificate to the contractor stating that the person providing the certificate is the prime contractor and is liable for the tax on the project. It also required the Department of Revenue to create the form and allowed the Department to disregard the certificate, if the contractor had reason to believe that the information in it was erroneous or incomplete. Even if the person who provides the certificate is not liable for the tax as a prime contractor, that person would be deemed to be the prime contractor in lieu of the contractor hired and would be subject to the tax for the work done by the contractor. The legislation also prevent the Department from assessing any penalty or interest on unreported tax liability due to off-site construction improvements from August 3, 1984 to June 30, 1991; however, the tax liability had to be reported and paid by December 31, 1991.

Laws 1992, Chapter 217 clarified that subcontractors who could demonstrate that services performed pertaining to manufactured buildings were within the control of a prime contractor or a dealership of manufactured buildings were not subject to state transaction privilege tax. It also clarified that the sale of furniture and fixtures that were not incorporated or attached to manufactured buildings is not taxable under prime contracting, but may be taxable under the retail classification.

The next significant development occurred in *Brink Electric Construction Co. et al v. Arizona Department of Revenue*, 193 Ariz. Adv. Rep. 56, 909 P.2d 421 (App. 1995). The case determined that an agency agreement was necessary for the purchase of exempt tangible personal property to be excluded from the contracting tax base. The Court also determined that machinery and equipment did not have to be permanently attached to real property for the activity to qualify as contracting.

In response to this decision, the Legislature passed Laws 1996, Chapter 319, to allow a deduction from the prime contracting classification for contracts entered into to install, assemble, repair or maintain machinery and equipment which is deductible from the retail base and that does not become permanently attached to a building, structure or other improvement. The legislation also defines "permanently attached" and creates requirements to establish entitlement to the deduction. This change became effective from and after June 30, 1997. There was also a legislative intent clause regarding the effect of this law on prior law stating that it was not intended to affect, nor could it be cited in the construction of the prime contracting classification statute for tax issues prior to its enactment.

In 1998, the Legislature passed Chapter 90. It eliminates the need for an agency agreement effective January 1, 1999 in order to receive the deduction from the prime contracting tax base for tangible personal property purchased for nonprofit hospitals or healthcare organizations, and certain machinery and equipment purchases exempt under the retail classification.

Laws 1998, Chapter 286, was also passed by the Legislature and exempts contracts entered into for installation of the pollution control equipment from the prime contracting classification effective for tax periods beginning January 1, 1999. This law exempts the gross proceeds or gross income derived from the installation, assembly, repair or maintenance of clean rooms from the prime contracting classification, retroactively to December 31, 1989. A claim for refund under this provision must be filed before July 31, 1998 and all refunds are limited to an aggregate of \$100,000. Finally, the law exempts tangible personal property sold to a individual subject to tax under the prime contracting classification or to a subcontractor under the control of a prime contractor, if it is incorporated or fabricated into any lake facility development in a commercial enhancement reuse district prescribed for under A.R.S. Section 42-5075.

Appendix C

APPENDIX C – SURVEY QUESTIONNAIRE RESPONSES

Respondent	Q1	Q2	Q3	Q4	Q5	Q6	Q7
Commercial 1	\$17,561,032	No	99.3%	\$400,422	2%	No	0%
Commercial 2	\$19,000,000	Yes	100%	\$11,400,000	20%	No	0%
Commercial 3	\$36,257,476	No	99.7%	\$205,925	1%	Yes	7%
Commercial 4	\$52,000,000	No	85%	\$30,000,000	1%	Yes	15%
Commercial 5	\$54,284,700	No	99.4%	\$11,213,271	0%	Yes	90.9%
Commercial 6	\$68,381,000	Prime	100%	\$2,259,000	2%	Yes	0.6%
Commercial 7	\$74,497,000	Generally, yes	98%	\$63,384,000	1%	No	0%
Commercial 8	\$78,444,690	Yes	100%	All work is subcontracted	0%	Yes	45%
Commercial 9	\$87,000,000	Yes	98%	\$5,500,000	0%	Yes	5.0%
Commercial 10	\$140,000,000	Subcontractor	0.0%	N/A	subcontractors purchase materials	N/A	0%
Commercial 11	\$147,437,742	Yes	100%	\$113,939,486	0%	Yes	6.7%
Commercial 12	\$181,000,000	Yes	100%	\$103,000,000	5%	Yes	25%
Electrical 1	\$2,642,586	No	0%	\$1,088,905	0%	N/A	0%
Electrical 2	\$3,000,000	No	3%	\$2,200,000	0%	Yes	100%
Electrical 3	\$6,045,000	No	13%	\$2,065,000	0%	No	0.0%
Electrical 4	\$8,867,323	No	96.72%	\$1,028	0%	No	0%
Electrical 5	\$10,000,000	No	15%	\$0	0%	Yes	1%
Electrical 6	\$11,390,000	No	17%	\$4,004,000	25%	No	0.0%
Electrical 7	\$14,000,000	No	35.0%	\$6,500,000	0%	No	0%
General 1	\$1,331,897	No	30%	\$250,652	0%	No	0.0%
General 2	\$5,258,000	Yes	100%	\$96,244	0%	Yes	100%
General 3	\$7,509,531	Yes	100%	\$339,726	0%	Yes	1.5%
General 4	\$8,972,435	Yes	100%	\$278,954	5%	No	
General 5	\$16,000,000	Yes	100%	\$9,600,000	20%	N/A	0.0%
General 6	\$3,400,000	No	10%	\$1,182,069	0%	Yes	90.0%
Heavy 1	\$43,231,000	No	82%	\$12,040,000	1%	Yes	19%
Heavy 2	\$19,051,107	not all	50%	\$0	0%	N/A	0%
Heavy 3	\$3,946,000	No	20%	\$1,025,000	0%	No	0%
Heavy 4	\$51,500,000	No	8%	\$17,200,000	1%	very little	0%
Heavy 5	\$54,798,000	No	99.0%	\$16,912,000	25%	Yes	15%
Heavy 6	\$23,500,000	No	48%	\$5,000,000	0%	No	0%
Heavy 7	\$52,026,578	Yes	100%	\$22,241,000	5%	No	0%
Homebuilder 1	\$10,000,000	Yes	N/A	N/A	N/A	N/A	N/A
Homebuilder 2	\$19,000,000	Yes	N/A	N/A	75%	No	0%
Homebuilder 3	\$24,735,000	Yes	N/A	\$4,925,000	0%	N/A	0%
Homebuilder 4	\$58,953,405	Yes	N/A	\$35,091,313	5%	Yes	0%
Homebuilder 5	\$65,196,000	Yes	N/A	labor & materials not separated	0%	No	0.0%
Homebuilder 6	\$65,335,365	Yes	N/A	\$492,100	0%	No	0%
Homebuilder 7	\$71,153,384	Yes	N/A	\$42,743,205	5%	Yes	0%
Homebuilder 8	\$78,301,609	Yes	N/A	\$35,235,724	0%	N/A	0%
Homebuilder 9	\$95,200,000	Yes	N/A	\$56,500,000	0%	No	0%
Homebuilder 10	\$0	Yes	N/A	\$5,048,776	5%	Yes	5%
Homebuilder 11	\$19,900,000	Yes	N/A	all work is subcontracted	0%	N/A	0%
Masonry 1	\$2,695,468	No	none	\$956,586	none	N/A	100%
Masonry 2	\$8,000,000	No	1%	\$3,700,573	none	No	0%
Mechanical 1	\$3,830,359	No	7.0%	\$956,463	none	Yes	31%
Mechanical 2	\$5,160,644	No	90%	\$1,626,024	unknown	No	0%
Mechanical 3	\$8,000,000	No	0%	\$3,690,000	none	No	0%
Mechanical 4	\$8,800,000	No	30%	\$2,600,000	40%	Yes	10%
Mechanical 5	\$9,000,000	No	unknown	unknown	0%	No	0%
Mechanical 6	\$9,500,000	No	71%	\$3,500,000	0%	N/A	100%
Mechanical 7	\$10,119,033	No	81%	\$3,838,253	13%	Yes	1.0%
Mechanical 8	\$10,800,000	No	11%	\$213,000	none	No	0.0%
Mechanical 9	\$74,650,000	No	75.0%	\$17,170,000	5%	Yes	40%
Telecommunications 1	\$690,224	Yes	100%	\$408,854	40%	Yes	2%
Telecommunications 2	\$1,201,838	No	1%	\$2,595	0%	No	0%
Telecommunications 3	\$5,915,000	No	10%	\$475,000	80%	No	0%
Telecommunications 4	\$42,450,000	Yes	100%	\$2,763,000	5%	No	0%

Respondent	Q8	Q9
Commercial 1	\$122,238--subcontractor working for a Prime Contractor	\$282,670
Commercial 2	0	\$2,500,000
Commercial 3	\$1,264,445--agency, \$1,574,090--qualified manufacturing, \$108,772.43 subcontracting	\$317,918
Commercial 4	\$7.8 million subcontracting	\$11,000,000
Commercial 5	\$325,708.20 subcontracting	\$2,547,664
Commercial 6	no other ones	\$2,846,000
Commercial 7	\$261,010--non-taxable construction services, \$1,489,940 subcontracting	\$3,574,900
Commercial 8	none	N/A
Commercial 9	hospital portion--factoring method for sales tax out, \$1.74 million subcontracting	\$15,000,000
Commercial 10	\$140,000,000	N/A
Commercial 11	none	\$28,454,000
Commercial 12	\$1,000,000--separate design services	\$10,900,000
Electrical 1	2,642,586	\$514,792
Electrical 2	\$2,880,000 subcontracting	\$960,000
Electrical 3	exempted subcontracting amounts - \$5,259,150	\$1,587,000
Electrical 4	\$290,635--subcontract labor	\$3,949,227
Electrical 5	subcontracting - \$8,500,000	\$3,500,000
Electrical 6	\$155,000--sales tax paid/factored, \$9,453,700 Subcontracting	\$3,200,000
Electrical 7	\$9.1 million subcontracting	\$4,400,000
General 1	\$932,000--subcontracting	\$391,312
General 2	0	\$239,000
General 3	0	\$187,326
General 4	N/A	\$230,911
General 5	none	\$6,400,000
General 6	\$3,000,000-subcontractor	\$1,123,155
Heavy 1	\$7,781,580 Subcontracting	\$9,901,000
Heavy 2	\$9,525,554 Subcontracting	\$4,725,400
Heavy 3	\$2,695,206--exempt sub-contracting income	\$709,306
Heavy 4	factoring out tax, \$14,380,000 Subcontracting	\$17,200,000
Heavy 5	\$550,000--subcontracting	\$5,525,000
Heavy 6	\$12,260,000--subcontract; \$493,000--sales tax	\$2,800,000
Heavy 7	none	\$5,115,186
Homebuilder 1	none	N/A
Homebuilder 2	\$5,500,000--land	\$10,800,000
Homebuilder 3	\$8,199,000--fair market land; \$786,000--factored tax	\$2,373,000
Homebuilder 4	\$11,790,681 = 20% land deduction	\$18,895,322
Homebuilder 5	none	labor & material not separated
Homebuilder 6	0	\$38,289,392
Homebuilder 7	\$13,958,737 = 20% land deduction, \$931,106 pipe deduction	\$23,015,572
Homebuilder 8	\$3,433,129--sales tax	\$43,065,885
Homebuilder 9	\$27,400,000 land and tax deductions, \$1,000,000 pipe deduction (4" pipe or greater)	\$30,400,000
Homebuilder 10	\$0	\$2,718,572
Homebuilder 11	\$716,000--state sales tax	N/A
Masonry 1	\$2,695,468	\$1,163,474
Masonry 2	\$7,900,000	\$2,300,000
Mechanical 1	\$3,554,157--subcontracting	\$595,572
Mechanical 2	\$516,064 Subcontracting	\$2,307,992
Mechanical 3	\$8,000,000 Subcontracting	\$2,168,000
Mechanical 4	\$7,187,000--subcontracts	\$2,040,000
Mechanical 5	subcontractor, sales tax	\$2,000,000
Mechanical 6	\$2,755,000 subcontracting	\$1,954,000
Mechanical 7	\$1,920,000--subcontracting	\$4,401,405
Mechanical 8	\$9,612,000 Subcontracting	\$390,000
Mechanical 9	\$18,662,000--out of state retail, sub contract CAD	\$42,550,000
Telecommunications 1	\$12,000--US govt. not taxed	\$249,107
Telecommunications 2	\$1,189,820 Subcontracting	\$310,074
Telecommunications 3	\$5,323,500 Subcontracting	\$1,232,000
Telecommunications 4	None	\$10,340,000

Respondent

Q10

Commercial 1	30 days
Commercial 2	150 days
Commercial 3	30 days
Commercial 4	90 days
Commercial 5	30 days
Commercial 6	45 days from billing; 21 to 51 days based on when billed
Commercial 7	30 days
Commercial 8	15-45 days
Commercial 9	29 days
Commercial 10	N/A
Commercial 11	1.5 - 2 yrs
Commercial 12	12-18 mos
Electrical 1	N/A
Electrical 2	N/A
Electrical 3	30 days; progress and monthly billings
Electrical 4	90 days
Electrical 5	45-60 days
Electrical 6	8 mos.
Electrical 7	bill monthly
General 1	starting time to receipt of first payment is 45-60 days
General 2	paid monthly and paid tax monthly (30 days)
General 3	30-40 days
General 4	start to 1st payment--50 to 60 days
General 5	6 mos.
General 6	6 mos
Heavy 1	11 mos
Heavy 2	9-10 mos
Heavy 3	6 mos
Heavy 4	public work monthly, private work -- 1 day - 2yrs, 6 mon. avg.
Heavy 5	10 months
Heavy 6	9 mos
Heavy 7	contracts last from 2 mos to 3 yrs, but tax is paid monthly
Homebuilder 1	tax was paid the month following closing
Homebuilder 2	start to finish/pmt = 6-7 mos; pmt to tax pmt = 1 mo.
Homebuilder 3	150 days
Homebuilder 4	8 months
Homebuilder 5	N/A
Homebuilder 6	5 mos
Homebuilder 7	8 months
Homebuilder 8	168 days
Homebuilder 9	3 to 4 months
Homebuilder 10	1 year
Homebuilder 11	4 mos
Masonry 1	not a prime contractor
Masonry 2	pay tax monthly
Mechanical 1	6 mos-1 year
Mechanical 2	pay tax monthly
Mechanical 3	N/A
Mechanical 4	4 mos
Mechanical 5	tax is paid following receipt
Mechanical 6	3 mos
Mechanical 7	start to first payment = 75 days; full cycle = 120 days
Mechanical 8	start-collection--45 days; finish-pay tax--60 days
Mechanical 9	45 days--tax paid based on invoice distribution
Telecommunications 1	new-30 to 45 days, finished-30 to 60 days. Avg. job -45 to 60 days, commercial - job - 10 to 30 days
Telecommunications 2	progress payments 30 days, tax 15 days after progress pmts.
Telecommunications 3	5 mos
Telecommunications 4	6 mos-1 year

1998 Arizona Contracting Questionnaire

1. How much in gross receipts did you make on Arizona contracting jobs in 1997?
2. Were you the prime contractor (were you responsible for paying sales tax on your gross receipts) for all of your jobs in 1997?
3. If not, what percentage of the jobs were you prime contractor?
4. How much did you spend on materials for incorporation in the project during 1997?
5. What percentage of those materials were purchased out-of-state?
6. Did you use agency authorization for purchases of materials in 1997?
7. What percentage of the materials purchased in 1997 in Arizona were purchased under agency and excluded from the tax base?
8. Other than the 35% exclusion and agency purchases, how much in gross receipts did you deduct or claim an exemption for in 1997? What was the basis for the exemption?
9. How much did you spend on labor in 1997?
10. What was the average time between starting the contract, receiving payment on the contract, finishing the contract and paying tax on the contract, when you were the prime contractor?

Name:

Address:

City:

Zip Code:

Telephone Number:

Appendix D

APPENDIX D – MONTHLY RETURNS OF THE STATE TREASURER’S FUNDS

The rate of return used was based on the yields from the State Treasurer’s Local Government Investment Pool (LGIP) and Local Government Investment Pool-Government (LGIP-GOVT) summarized below:

<u>Month</u>	<u>LGIP Yield</u>	<u>LGIP-GOVT Yield</u>
July-95	5.829%	
August-95	5.799%	
September-95	5.794%	
October-95	5.801%	
November-95	5.887%	5.406%
December-95	5.953%	5.376%
January-96	5.796%	5.284%
February-96	5.428%	5.215%
March-96	5.378%	5.140%
April-96	5.485%	5.147%
May-96	5.437%	5.162%
June-96	5.489%	5.489%
July-96	5.494%	5.271%
August-96	5.494%	5.308%
September-96	5.563%	5.193%
October-96	5.498%	5.250%
November-96	5.491%	5.212%
December-96	5.510%	5.237%
January-97	5.550%	5.287%
February-97	5.635%	5.178%
March-97	5.521%	5.281%
April-97	5.576%	5.314%
May-97	5.696%	5.434%
June-97	5.746%	5.486%
July-97	5.672%	5.534%
August-97	5.728%	5.527%
September-97	5.760%	5.530%
October-97	5.705%	5.538%
November-97	5.850%	5.418%
December-97	5.878%	5.629%
January-98	5.910%	5.467%
February-98	5.948%	5.595%
March-98	5.758%	5.439%
April-98	5.785%	5.469%
May-98	5.743%	5.391%
June-98	5.786%	5.456%
July-98	5.741%	5.404%
August-98	5.700%	5.396%
September-98	5.676%	5.375%
Average	5.679%	5.367%

Appendix E

APPENDIX E – DATA DETAIL

Census of Construction Data from Selected Tables

Number of Establishments:

<u>Industry</u>	<u>Total Number</u>	<u>Without Payroll</u>	<u>With Payroll</u>
1992			
Construction Industries	22,568	14,262	8,306
Building construction -- General contractors and operative contractors	4,321	2,094	2,227
Heavy Construction other than building construction -- contractors	672	234	438
Special trade contractors	17,576	11,934	5,642
1987			
Construction Industries	25,730	16,827	8,903
Building construction -- General contractors and operative contractors	5,189	2,983	2,206
Heavy Construction other than building construction -- contractors	743	249	494
Special trade contractors	18,910	12,944	5,966

Source: *1992 Census of Construction Industries, Mountain States, Arizona*, Table 1, Page AZ-5, U.S. Commerce Department, Bureau of the Census

Detail of Establishments with Payroll:

	<u>1992</u>	<u>1987</u>	<u>1982</u>	<u>1977</u>
Number of establishments	8,306	8,903	6,803	5,285
Net Value of Construction	6,822,623	6,792,209	3,580,366	2,157,553
Materials, components, and supplies	2,705,631	2,767,021	1,539,050	885,882

Source: *1992 Census of Construction Industries, Mountain States, Arizona*, Table 3, Page AZ-8, U.S. Commerce Department, Bureau of the Census

State Data Center, University of Arizona – Raw Data from Jan. 1987 – Dec. 1997

DATE/(Year then Month)	Arizona Res. Construction Awards (\$000)	Arizona Non- Res. Construction Awards (\$000)	Arizona Non-Building Const. Awards (\$000)	Arizona Construction Employ. (000)
198701	199,695	194,107	53,386	103
198702	245,883	95,901	19,408	102
198703	284,513	180,328	16,363	103
198704	269,658	159,042	64,243	103
198705	250,559	195,698	86,761	104
198706	257,059	195,358	67,955	106
198707	283,044	180,538	80,906	105
198708	265,288	179,059	89,819	105
198709	272,543	155,155	84,643	104
198710	235,274	236,868	161,933	103
198711	164,862	134,604	60,952	101
198712	146,268	151,073	39,845	100
198801	184,569	167,310	72,594	93
198802	195,847	185,307	93,388	92
198803	233,018	121,946	37,637	93
198804	246,245	145,797	82,531	92
198805	257,476	177,362	112,297	93
198806	221,303	199,773	98,750	96
198807	205,884	199,878	82,767	96
198808	256,854	192,093	29,934	97
198809	194,131	126,501	60,134	96
198810	181,283	128,734	36,446	93
198811	156,042	192,601	62,095	92
198812	153,900	91,546	60,322	91
198901	174,870	131,601	77,044	85
198902	156,997	182,216	77,894	85
198903	194,569	140,181	51,089	85
198904	198,731	111,628	137,994	85
198905	184,613	154,282	82,774	85
198906	201,812	131,798	92,729	87
198907	184,283	139,180	123,869	87
198908	198,634	271,807	33,220	88
198909	168,689	198,910	103,993	87
198910	170,540	93,628	139,011	86
198911	169,845	111,459	111,463	85
198912	153,756	102,707	64,715	84
199001	149,065	154,380	182,862	80
199002	152,158	95,075	28,797	80
199003	176,333	137,623	92,083	81
199004	173,726	83,235	121,473	81
199005	202,983	137,890	114,827	82
199006	178,124	146,468	97,856	84
199007	195,847	117,039	80,457	84
199008	229,542	121,297	32,123	86

DATE/(Year then Month)	Arizona Res. Construction Awards (\$000)	Arizona Non- Res. Construction Awards (\$000)	Arizona Non-Building Const. Awards (\$000)	Arizona Construction Employ. (000)
199009	179,644	145,889	58,725	85
199010	171,141	126,940	108,487	84
199011	116,673	153,056	68,037	83
199012	103,249	84,775	24,680	81
199101	146,201	76,863	67,730	76
199102	148,437	91,433	38,355	75
199103	200,681	67,339	57,436	76
199104	189,569	95,902	65,500	76
199105	219,572	138,994	55,242	77
199106	241,832	95,507	57,004	78
199107	248,666	130,592	97,807	79
199108	245,773	129,095	117,672	79
199109	212,208	82,102	167,627	78
199110	250,193	131,835	84,511	78
199111	184,633	58,768	90,426	78
199112	210,516	83,468	81,056	77
199201	212,931	122,966	97,419	74
199202	217,882	127,860	64,575	74
199203	277,164	165,177	41,915	75
199204	254,403	105,658	58,077	78
199205	261,497	135,068	46,690	80
199206	287,611	152,440	93,708	81
199207	285,505	153,807	70,486	82
199208	280,005	143,787	65,834	83
199209	316,814	87,567	123,673	83
199210	295,023	100,144	33,022	83
199211	190,565	59,794	19,819	82
199212	263,339	94,814	51,212	81
199301	188,785	73,678	48,813	77
199302	274,077	67,700	92,040	79
199303	340,233	77,586	91,196	82
199304	360,890	100,218	59,829	85
199305	321,185	79,792	94,128	87
199306	398,508	160,359	153,729	89
199307	350,402	97,771	69,324	92
199308	336,649	140,367	77,568	93
199309	417,260	163,922	56,993	94
199310	340,761	148,644	88,403	96
199311	341,608	93,377	45,645	97
199312	325,959	145,522	52,381	98
199401	368,854	77,360	27,191	97
199402	433,193	103,437	67,307	99
199403	546,631	156,702	95,533	102
199404	487,833	122,324	89,929	103
199405	460,003	159,758	58,407	105
199406	494,838	165,526	90,258	108
199407	316,036	192,727	51,848	109
199408	485,243	147,110	113,074	110

DATE/(Year then Month)	Arizona Res. Construction Awards (\$000)	Arizona Non- Res. Construction Awards (\$000)	Arizona Non-Building Const. Awards (\$000)	Arizona Construction Employ. (000)
199409	458,572	149,564	72,937	112
199410	473,447	141,826	74,603	113
199411	427,160	256,548	109,092	114
199412	356,421	134,018	38,411	114
199501	352,457	183,508	40,108	112
199502	339,184	154,027	66,334	114
199503	423,707	203,211	79,499	116
199504	379,687	167,330	65,940	116
199505	539,816	231,413	204,441	118
199506	545,712	289,626	85,796	122
199507	473,014	149,902	116,882	121
199508	466,334	123,592	123,817	123
199509	459,509	135,373	93,421	123
199510	425,366	181,704	102,312	124
199511	434,042	286,153	65,764	124
199512	433,030	326,377	52,583	125
199601	380,139	101,420	76,001	122
199602	487,618	193,215	205,122	123
199603	576,095	174,205	99,828	124
199604	569,507	143,920	94,587	122
199605	571,663	186,716	71,222	125
199606	524,827	228,638	112,482	128
199607	514,470	160,539	115,628	127
199608	500,331	342,273	123,961	128
199609	477,117	361,127	52,769	129
199610	490,994	274,782	113,738	130
199611	348,570	171,122	190,746	130
199612	390,577	211,782	75,613	130
199701	319,037	135,662	105,887	124
199702	414,154	137,236	62,485	126
199703	490,658	189,645	161,429	127
199704	531,950	196,888	204,763	128
199705	500,683	222,869	78,019	131
199706	490,446	378,010	185,944	133
199707	447,915	156,943	100,292	134
199708	442,154	172,535	121,350	135
199709	516,791	247,842	70,453	134
199710	477,651	250,089	66,058	136
199711	315,071	154,759	37,402	135
199712	NA	NA	NA	NA

Sources:

Data Received from the State Data Center, The University of Arizona, Economic & Business Research Program, College of Business & Public Administration, Tucson, AZ: Residential Construction Awards, Non Residential Construction Awards, Non-Building Construction Award, Source: F.W. Dodge
Construction Employment, Source: Arizona Department of Economic Security

State Data Center, University of Arizona – Raw Data From Jan. 1987 – Dec. 1997 (Cont'd)

DATE/(Year then Month)	Arizona Taxable Sales for Contracting Accrual (\$000)	Housing Units Authorized Permits Single Units	Housing Units Authorized Permits 2 to 4 Units	Housing Units Authorized Permits Total
198701	335,978	2,130	112	3,556
198702	326,434	2,542	58	3,239
198703	347,521	2,973	123	4,075
198704	447,902	2,846	125	3,441
198705	416,498	2,610	82	3,346
198706	386,203	2,642	51	3,271
198707	380,799	2,243	42	3,557
198708	368,753	2,229	49	3,013
198709	393,994	2,298	80	4,445
198710	371,458	2,058	51	3,126
198711	354,729	1,474	17	2,035
198712	387,866	1,444	55	2,531
198801	291,289	1,552	33	1,691
198802	297,124	1,779	18	2,105
198803	335,427	2,388	71	3,650
198804	334,189	2,203	27	3,647
198805	348,272	2,271	149	2,987
198806	362,226	2,414	88	3,988
198807	358,637	2,074	13	2,383
198808	361,164	2,259	60	3,411
198809	373,089	1,809	19	2,231
198810	324,853	1,666	48	2,450
198811	378,903	1,487	28	2,079
198812	390,412	1,474	35	1,906
198901	308,352	1,331	74	1,628
198902	309,220	1,381	38	1,745
198903	343,415	1,984	68	2,341
198904	313,891	1,878	46	1,992
198905	340,471	1,696	36	2,204
198906	377,634	1,960	19	2,189
198907	323,348	1,721	48	2,001
198908	326,829	2,149	40	2,472
198909	346,495	1,676	16	1,959
198910	338,093	1,579	54	1,857
198911	348,606	1,363	35	1,489
198912	384,286	1,329	17	1,438
199001	294,672	1,537	37	2,679
199002	299,117	1,449	18	1,664
199003	330,175	1,777	32	1,943
199004	321,226	1,711	59	2,028
199005	365,581	2,026	22	2,119
199006	357,127	1,835	26	2,136
199007	330,132	1,671	35	2,189
199008	351,239	1,778	39	2,187
199009	341,521	1,450	23	1,565

DATE/(Year then Month)	Arizona Taxable Sales for Contracting Accrual (\$000)	Housing Units Authorized Permits Single Units	Housing Units Authorized Permits 2 to 4 Units	Housing Units Authorized Permits Total
199010	380,507	1,452	46	1,643
199011	331,397	1,074	28	1,686
199012	337,964	990	36	1,044
199101	321,497	1,258	56	1,350
199102	314,557	1,323	65	1,454
199103	292,899	1,739	49	1,844
199104	290,973	1,904	38	2,021
199105	324,116	1,938	44	2,017
199106	315,684	1,992	42	2,073
199107	320,839	2,147	26	2,207
199108	325,662	1,999	18	2,246
199109	331,651	2,082	39	2,540
199110	320,649	2,072	28	2,250
199111	319,443	1,548	12	1,898
199112	333,380	1,497	11	1,521
199201	288,026	1,954	58	2,074
199202	317,979	2,033	33	2,073
199203	344,555	2,591	34	2,733
199204	330,964	2,364	57	2,967
199205	321,413	2,227	29	2,283
199206	377,392	2,542	56	2,661
199207	353,653	2,682	106	3,097
199208	350,745	2,541	41	2,966
199209	378,087	2,758	69	2,939
199210	361,566	2,620	39	2,824
199211	369,492	2,261	53	2,422
199212	396,562	2,262	18	2,326
199301	269,289	1,694	44	2,111
199302	313,179	2,281	54	2,362
199303	376,144	2,991	75	3,126
199304	392,648	3,100	76	3,533
199305	376,106	2,591	44	2,670
199306	421,694	3,128	105	3,849
199307	406,029	2,998	37	3,085
199308	424,939	2,993	36	3,367
199309	435,395	3,412	94	3,604
199310	421,597	3,238	120	3,677
199311	424,415	2,724	79	3,151
199312	500,076	3,233	71	3,844
199401	389,977	3,019	94	3,896
199402	442,878	3,155	82	3,620
199403	516,589	4,202	135	4,603
199404	465,779	3,855	96	4,404
199405	508,169	3,913	148	4,873
199406	516,673	4,038	228	4,388
199407	520,448	3,264	114	5,007
199408	498,695	3,521	96	4,736
199409	546,912	3,165	148	4,481

DATE/(Year then Month)	Arizona Taxable Sales for Contracting Accrual (\$000)	Housing Units Authorized Permits Single Units	Housing Units Authorized Permits 2 to 4 Units	Housing Units Authorized Permits Total
199410	503,858	3,654	83	4,659
199411	545,875	2,685	67	3,042
199412	566,374	2,721	155	3,309
199501	461,019	2,507	68	3,113
199502	497,074	2,402	71	3,871
199503	550,624	3,394	119	4,837
199504	390,314	3,146	143	4,452
199505	411,997	3,827	134	5,066
199506	614,760	4,087	104	4,832
199507	537,586	3,652	104	4,290
199508	601,334	4,014	135	5,102
199509	596,178	3,414	106	4,838
199510	615,824	3,477	112	3,920
199511	569,104	3,171	90	4,004
199512	665,811	2,897	129	4,323
199601	549,079	3,053	69	4,422
199602	580,997	3,167	57	5,302
199603	603,485	4,101	50	5,153
199604	623,540	4,149	62	5,216
199605	625,409	3,930	70	4,622
199606	678,136	3,574	75	4,258
199607	655,432	3,665	81	4,626
199608	657,027	3,329	73	3,518
199609	679,983	3,266	69	4,619
199610	664,920	3,058	93	4,250
199611	629,573	2,437	101	2,675
199612	713,799	2,883	36	3,836
199701	543,100	3,192	54	3,376
199702	581,334	2,980	38	3,872
199703	639,901	3,507	152	3,922
199704	669,314	3,910	82	4,625
199705	665,282	3,715	66	4,455
199706	741,118	3,645	54	3,925
199707	678,844	3,777	19	3,892
199708	694,344	3,694	105	4,956
199709	752,225	4,155	54	5,507
199710	702,339	3,563	81	5,113
199711	NA	2,875	34	3,753
199712	NA	NA	NA	NA

Sources:

Data Received from the State Data Center, The University of Arizona, Economic & Business Research Program, College of Business & Public Administration, Tucson, AZ: Arizona Taxable Sales for Contracting, Source: University of Arizona based on Arizona Department of Revenue Collection Data.

Housing Units Authorized by Building Permits, Source: U.S. Department of Commerce, Bureau of the Census

The Business Journal's Top 25 Commercial Contractors – Detail 1995 – 1998

Total Billings

Rank	Company Name	1996 Total Billings(mil)	1995 Total Billings(mil)	1994 Total Billings(mil)	1993 Total Billings(mil)
12	Big-D Construction Corp	-	-	-	46.7
24	Butte Construction Inc.	-	21.1	18.5	-
24	Case Group	-	-	17.7	-
21	Caviness Construction Co. Inc.	-	24.0	29.0	12.0
10	Cohen Contracting Inc.	80.5	62.0	46.0	38.0
19	Conelly Swinerton Cons Co	43.0	24.0	-	-
7	D.L. Withers Construction	102.0	101.0	96.0	78.4
18	Decca Construction Co. Inc.	-	-	30.1	48.0
22	Devcon Enterprise Inc.	33.6	21.6	21.4	-
23	Double AA Builders Ltd.	30.1	-	-	-
21	DPR Construction Inc.	35.0	-	-	-
25	GR Walton General Contractors Inc.	26.4	-	-	-
1	Huber Hunt & Nichols Inc.	477.0	959.0	612.0	645.0
9	Joe E. Woods Inc.	89.2	78.4	73.1	59.8
14	Johnson Carlier Inc.	58.5	48.9	51.9	39.8
19	Jokake Construction Inc.	-	27.1	16.4	12.2
6	Kitchell Contractors	136.5	106.6	83.8	92.6
21	Koll Construction	-	-	-	16.5
20	Linthicum Constructors Inc.	42.0	38.4	24.9	25.0
25	LMB Building Solutions	-	20.1	39.7	37.4
5	McCarthy	155.0	122.5	191.6	141.6
17	Okland Construction Co. Inc.	-	44.0	43.0	-
11	Opus Southwest Corp	75.0	65.5	-	-
3	Perini Building Co. Inc.	313.7	327.6	358.0	400.0
18	RAS Builders Inc.	45.0	-	-	-
15	SDB Inc.	50.0	75.3	70.6	25.3
12	Summit Builders Construction Co	71.9	53.8	44.7	42.0
4	Sundt Corp	209.6	221.2	226.9	114.5
20	Sun eagle Corp	-	-	-	19.7
8	Target General Inc.	96.0	97.0	78.0	47.0
2	The Chanen Corp	354.2	376.5	301.2	167.4
16	The Weitz Co. Inc.	46.1	58.0	63.4	53.0
13	Turner/On Site	66.8	-	-	-
17	W.E. O'Neil Cons Co of AZ	45.3	60.6	52.0	43.4
24	W.M. Grace Construction Inc.	27.3	26.8	29.4	14.7
	TOTAL	2,709.7	3,061.0	2,619.3	2,220.0

"-" Indicates entity was not ranked during the year

"WND" Indicates would not disclose

Contracts Awarded

Rank	Company Name	1996 AZ Contracts Awarded (mil)	1995 AZ Contracts Awarded (mil)	1994 AZ Contracts Awarded (mil)	1993 AZ Contracts Awarded (mil)
12	Big-D Construction Corp	-	-	-	58.8
24	Butte Construction Inc.	-	28.0	13.2	-
24	Case Group	-	-	40.8	-
21	Caviness Construction Co. Inc.	-	27.1	25.4	14.2
10	Cohen Contracting Inc.	92.0	65.0	49.4	40.4
19	Conelly Swinerton Cons Co	56.8	31.0	-	-
7	D.L. Withers Construction	97.3	90.0	96.0	81.0
18	Decca Construction Co. Inc.	-	-	26.7	33.2
22	Devcon Enterprise Inc.	39.7	29.5	21.4	-
23	Double AA Builders Ltd.	34.4	-	-	-
21	DPR Construction Inc.	92.0	-	-	-
25	GR Walton General Contractors Inc.	32.6	-	-	-
1	Huber Hunt & Nichols Inc.	535.0	785.0	862.5	924.0
9	Joe E. Woods Inc.	62.4	80.7	67.2	67.5
14	Johnson Carlier Inc.	38.8	37.0	26.3	46.4
19	Jokake Construction Inc.	-	34.0	21.9	12.9
6	Kitchell Contractors	130.1	189.8	107.1	127.2
21	Koll Construction	-	-	-	16.0
20	Linthicum Constructors Inc.	55.0	39.2	25.7	14.4
25	LMB Building Solutions	-	27.4	51.8	31.4
5	McCarthy	132.0	186.0	45.0	312.0
17	Okland Construction Co. Inc.	-	51.3	56.0	-
11	Opus Southwest Corp	120.0	105.0	-	-
3	Perini Building Co. Inc.	223.0	48.6	251.0	363.0
18	RAS Builders Inc.	45.0	-	-	-
15	SDB Inc.	35.0	45.3	92.5	40.2
12	Summit Builders Construction Co	81.0	64.0	49.0	41.0
4	Sundt Corp	205.4	210.7	248.6	131.4
20	Sun eagle Corp	-	-	-	19.7
8	Target General Inc.	152.0	98.1	74.0	65.0
2	The Chanen Corp	354.2	376.5	301.2	167.4
16	The Weitz Co. Inc.	40.6	60.6	45.0	36.2
13	Turner/On Site	66.8	-	-	-
17	W.E. O'Neil Cons Co of AZ	77.9	50.2	50.0	46.0
24	W.M. Grace Construction Inc.	26.4	28.4	31.8	20.6
	TOTAL	2,825.4	2,788.4	2,679.5	2,709.9

"-" Indicates entity was not ranked during the year

"WND" Indicates would not disclose

Contracts Completed

Rank	Company Name	1996 AZ Contracts Completed (mil)	1995 AZ Contracts Completed (mil)	1994 AZ Contracts Completed (mil)	1993 AZ Contracts Completed (mil)
12	Big-D Construction Corp	-	-	-	47.5
24	Butte Construction Inc.	-	9.5	19.8	-
24	Case Group	-	-	5.1	-
21	Caviness Construction Co. Inc.	-	22.5	25.4	12.0
10	Cohen Contracting Inc.	75.0	52.5	42.6	34.0
19	Conelly Swinerton Cons Co	15.0	24.0	-	-
7	D.L. Withers Construction	88.1	120.0	94.0	60.0
18	Decca Construction Co. Inc.	-	-	24.7	34.8
22	Devcon Enterprise Inc.	25.5	21.6	21.4	-
23	Double AA Builders Ltd.	24.5	-	-	-
21	DPR Construction Inc.	35.0	-	-	-
25	GR Walton General Contractors Inc.	20.8	-	-	-
1	Huber Hunt & Nichols Inc.	580.0	870.0	368.0	210.0
9	Joe E. Woods Inc.	89.2	78.4	73.9	58.4
14	Johnson Carlier Inc.	26.6	28.6	29.4	35.3
19	Jokake Construction Inc.	-	29.3	16.4	12.2
6	Kitchell Contractors	147.7	153.0	171.7	183.4
21	Koll Construction	-	-	-	4.0
20	Linthicum Constructors Inc.	39.8	35.0	28.6	25.0
25	LMB Building Solutions	-	17.2	32.2	33.0
5	McCarthy	180.0	130.0	210.0	190.0
17	Okland Construction Co. Inc.	-	27.0	17.0	-
11	Opus Southwest Corp	65.0	65.0	-	-
3	Perini Building Co. Inc.	65.0	27.9	170.0	495.0
18	RAS Builders Inc.	42.0	-	-	-
15	SDB Inc.	63.0	33.8	572.0	15.5
12	Summit Builders Construction Co	68.7	46.0	44.0	41.0
4	Sundt Corp	130.2	331.1	258.7	89.2
20	Sun eagle Corp	-	-	-	19.7
8	Target General Inc.	96.0	57.7	68.0	43.0
2	The Chanen Corp	WND	WND	WND	WND
16	The Weitz Co. Inc.	55.4	57.1	45.6	84.5
13	Turner/On Site	39.3	-	-	-
17	W.E. O'Neil Cons Co of AZ	45.7	49.9	41.0	43.4
24	W.M. Grace Construction Inc.	24.7	24.7	23.0	14.7
	TOTAL	2,042.2	2,311.8	2,402.5	1,785.6

"-" Indicates entity was not ranked during the year
"WND" Indicates would not disclose

Percentage of Work Done In State

Rank	Company Name	1996 % of Work Domestic	1995% of Work Domestic	1994% of Work Domestic	1993% of Work Domestic
12	Big-D Construction Corp	-	-	-	33
24	Butte Construction Inc.	-	100	100	-
24	Case Group	-	-	wnd	-
21	Caviness Construction Co. Inc.	-	100	100	100
10	Cohen Contracting Inc.	95	100	100	90
19	Conelly Swinerton Cons Co	100	100	-	-
7	D.L. Withers Construction	100	100	100	100
18	Decca Construction Co. Inc.	-	-	100	100
22	Devcon Enterprise Inc.	85	90	100	-
23	Double AA Builders Ltd.	100	-	-	-
21	DPR Construction Inc.	100	-	-	-
25	GR Walton General Contractors Inc.	70	-	-	-
1	Huber Hunt & Nichols Inc.	95	95	80	80
9	Joe E. Woods Inc.	69	71	89	83
14	Johnson Carlier Inc.	93	92	93	88
19	Jokake Construction Inc.	-	100	100	100
6	Kitchell Contractors	87	74	58	68
21	Koll Construction	-	-	-	20
20	Linthicum Constructors Inc.	100	100	100	100
25	LMB Building Solutions	-	61	58	33
5	McCarthy	70	80	98	100
17	Okland Construction Co. Inc.	-	100	100	-
11	Opus Southwest Corp	85	85	-	-
3	Perini Building Co. Inc.	30	15	15	12
18	RAS Builders Inc.	100	-	-	-
15	SDB Inc.	100	100	100	100
12	Summit Builders Construction Co	70	65	70	70
4	Sundt Corp	52	56	wnd	50
20	Sun eagle Corp	-	-	-	100
8	Target General Inc.	100	100	100	100
2	The Chanen Corp	100	100	100	100
16	The Weitz Co. Inc.	18	15	100	100
13	Turner/On Site	100	-	-	-
17	W.E. O'Neil Cons Co of AZ	100	100	100	100
24	W.M. Grace Construction Inc.	90	65	60	100

"-" Indicates entity was not ranked during the year
"WND" Indicates would not disclose

Appendix F

APPENDIX F – EXTRAPOLATED DATA

Est. Value of Construction Put In Place and Exp. for Res. Main. & Repairs for Arizona

Year	U.S. Total Construction Awards	AZ Total Construction Awards*	Percent of Total
1992	234,913	5,330	2.27%
1993	242,952	5,618	2.31%
1994	283,647	7,298	2.57%
1995	300,224	8,350	2.78%
1996	319,745	9,246	2.89%
1997	343,274	9,722	2.83%
1998	364,186	9,916	2.72%

(in Millions of Dollars)

Source: McGraw-Hill Information Systems, F.W. Dodge Division, US data from *New England Economic Indicators Database* (11/10/98), Federal Reserve Bank of Boston, www.std.com/frbbos/economic/nee/neeidata/ct.txt, AZ data from UofA Data Center (1/16/98)

*FY98 estimated based on 2% growth from FY97

Fiscal Year	Annual Value of Construction Put in Place*	Expenditures For Residential Maintenance & Repairs@	Est. AZ Total Construction Put In Place & Res. Maint. & Rep.**
1992	434,795	195,200	14,294.09
1993	462,601	167,700	14,574.91
1994	496,489	168,600	17,111.32
1995	532,039	169,900	19,523.72
1996	553,902	160,100	20,647.48
1997	602,011	145,800	21,178.84
1998	632,087	157,000	21,485.87

(in Millions of Dollars)

*Source: *Value of Construction Put in Place, August 1998, C30/98-8*, Table 3 and Historical Information from the U.S. Dept. of Commerce, Bureau of the Census

**Estimated based on average AZ percentage of US Total Construction Awards above

@Source: *Expenditures for Residential Improvements and Repairs, First Quarter 1998, C50/98-Q1, August 1998*, U.S. Dept. of Commerce, Bureau of the Census
Fiscal 1998 estimated using first quarter 1998 amount for second quarter 1998.

Data Detail – Value of Construction Put In Place

Source: *Value of Construction Put in Place, August 1998, C30/98-8*, Table 3 and Historical Information from the U.S. Department of Commerce, Bureau of the Census.

Not Seasonally Adjusted In Current Dollars (in Millions)

Year/ Month	Total New Construction	Year/ Month	Total New Construction	Year/ Month	Total New Construction	Fiscal Year	Total New Construction
199101	28,990	199405	44,664	199709	59,480	1992	434,795
199102	28,528	199406	47,921	199710	58,365	1993	462,601
199103	30,650	199407	48,447	199711	53,508	1994	496,489
199104	34,035	199408	50,760	199712	47,515	1995	532,039
199105	36,073	199409	50,227	199801	42,419	1996	553,902
199106	37,634	199410	48,609	199802	41,199	1997	602,011
199107	38,794	199411	45,864	199803	46,531	1998	632,087
199108	41,162	199412	40,747	199804	51,265		
199109	40,184	199501	36,055	199805	54,292		
199110	39,728	199502	35,007	199806	59,690		
199111	36,256	199503	39,642	199807	60,807		
199112	32,142	199504	42,206	199808	62,663		
199201	29,175	199505	45,776				
199202	28,770	199506	48,699				
199203	32,828	199507	49,270				
199204	35,547	199508	51,598				
199205	38,881	199509	51,164				
199206	41,328	199510	50,142				
199207	41,982	199511	47,038				
199208	42,884	199512	41,537				
199209	42,861	199601	37,784				
199210	42,282	199602	36,260				
199211	39,736	199603	40,514				
199212	35,812	199604	45,658				
199301	31,214	199605	49,906				
199302	30,559	199606	53,031				
199303	34,414	199607	54,170				
199304	37,104	199608	56,370				
199305	40,129	199609	56,513				
199306	43,624	199610	55,820				
199307	44,053	199611	52,175				
199308	45,927	199612	45,437				
199309	45,857	199701	40,440				
199310	44,504	199702	39,927				
199311	42,849	199703	44,448				
199312	38,414	199704	48,594				
199401	32,761	199705	52,329				
199402	31,869	199706	55,788				
199403	37,191	199707	57,921				
199404	40,479	199708	59,902				

Data Detail – Value of Construction Contracts

Source: McGraw-Hill Information Systems, F. W. Dodge Division, U.S. data from *New England Economic Indicators* Database of as 11/10/98, Federal Reserve Bank of Boston, www.std.com/frbbos/economic/needi/needata/ct.txt and Arizona data from the University of Arizona Data Center as of 1/16/98.

Year/ Month	U.S. Total Construction Awards (\$millions)	Arizona Res. Construction Awards (\$000)	Arizona Non- Res. Construction Awards (\$000)	Arizona Non- Building Const. Awards (\$000)	Arizona Total Construction Awards (\$millions)
9107	21,283.0	248,666	130,592	97,807	477.065
9108	21,557.0	245,773	129,095	117,672	492.54
9109	19,411.0	212,208	82,102	167,627	461.937
9110	22,738.0	250,193	131,835	84,511	466.539
9111	15,082.0	184,633	58,768	90,426	333.827
9112	16,277.0	210,516	83,468	81,056	375.04
9201	16,076.0	212,931	122,966	97,419	433.316
9202	17,037.0	217,882	127,860	64,575	410.317
9203	20,510.0	277,164	165,177	41,915	484.256
9204	21,746.0	254,403	105,658	58,077	418.138
9205	19,787.0	261,497	135,068	46,690	443.255
9206	23,409.0	287,611	152,440	93,708	533.759
9207	21,678.0	285,505	153,807	70,486	509.798
9208	20,170.0	280,005	143,787	65,834	489.626
9209	19,715.0	316,814	87,567	123,673	528.054
9210	23,836.0	295,023	100,144	33,022	428.189
9211	16,530.0	190,565	59,794	19,819	270.178
9212	16,387.0	263,339	94,814	51,212	409.365
9301	16,382.0	188,785	73,678	48,813	311.276
9302	16,311.0	274,077	67,700	92,040	433.817
9303	21,522.0	340,233	77,586	91,196	509.015
9304	22,097.0	360,890	100,218	59,829	520.937
9305	21,140.0	321,185	79,792	94,128	495.105
9306	27,184.0	398,508	160,359	153,729	712.596
9307	23,002.0	350,402	97,771	69,324	517.497
9308	22,676.0	336,649	140,367	77,568	554.584
9309	24,154.3	417,260	163,922	56,993	638.175
9310	24,923.4	340,761	148,644	88,403	577.808
9311	21,481.9	341,608	93,377	45,645	480.63
9312	19,525.6	325,959	145,522	52,381	523.862
9401	18,354.4	368,854	77,360	27,191	473.405
9402	20,131.9	433,193	103,437	67,307	603.937
9403	27,359.8	546,631	156,702	95,533	798.866
9404	25,161.6	487,833	122,324	89,929	700.086
9405	27,138.0	460,003	159,758	58,407	678.168
9406	29,738.4	494,838	165,526	90,258	750.622
9407	25,891.6	316,036	192,727	51,848	560.611
9408	28,936.6	485,243	147,110	113,074	745.427
9409	26,380.4	458,572	149,564	72,937	681.073
9410	25,084.3	473,447	141,826	74,603	689.876
9411	22,504.2	427,160	256,548	109,092	792.8
9412	19,532.9	356,421	134,018	38,411	528.85
9501	19,959.0	352,457	183,508	40,108	576.073
9502	20,458.6	339,184	154,027	66,334	559.545

Data Detail – Value of Construction Contracts (cont'd)

Year/ Month	U.S. Total Construction Awards (\$millions)	Arizona Res. Construction Awards (\$000)	Arizona Non- Res. Construction Awards (\$000)	Arizona Non- Building Const. Awards (\$000)	Arizona Total Construction Awards (\$millions)
9503	26,471.2	423,707	203,211	79,499	706.417
9504	23,807.8	379,687	167,330	65,940	612.957
9505	29,329.5	539,816	231,413	204,441	975.67
9506	31,868.2	545,712	289,626	85,796	921.134
9507	27,590.4	473,014	149,902	116,882	739.798
9508	29,681.8	466,334	123,592	123,817	713.743
9509	26,655.8	459,509	135,373	93,421	688.303
9510	26,956.4	425,366	181,704	102,312	709.382
9511	23,712.9	434,042	286,153	65,764	785.959
9512	19,892.0	433,030	326,377	52,583	811.99
9601	21,583.6	380,139	101,420	76,001	557.56
9602	21,166.6	487,618	193,215	205,122	885.955
9603	28,065.8	576,095	174,205	99,828	850.128
9604	30,602.3	569,507	143,920	94,587	808.014
9605	32,148.9	571,663	186,716	71,222	829.601
9606	31,688.8	524,827	228,638	112,482	865.947
9607	31,880.0	514,470	160,539	115,628	790.637
9608	31,820.7	500,331	342,273	123,961	966.565
9609	28,085.7	477,117	361,127	52,769	891.013
9610	28,427.4	490,994	274,782	113,738	879.514
9611	24,389.1	348,570	171,122	190,746	710.438
9612	21,721.0	390,577	211,782	75,613	677.972
9701	23,110.4	319,037	135,662	105,887	560.586
9702	22,991.6	414,154	137,236	62,485	613.875
9703	29,390.6	490,658	189,645	161,429	841.732
9704	32,271.3	531,950	196,888	204,763	933.601
9705	34,233.4	500,683	222,869	78,019	801.571
9706	34,952.9	490,446	378,010	185,944	1054.4
9707	33,406.3	447,915	156,943	100,292	705.15
9708	32,166.4	442,154	172,535	121,350	736.039
9709	31,851.7	516,791	247,842	70,453	835.086
9710	32,464.4	477,651	250,089	66,058	793.798
9711	25,573.4	315,071	154,759	37,402	507.232
9712	24,487.8				
9801	24,624.0				
9802	24,422.5				
9803	31,251.0				
9804	33,310.6				
9805	34,146.8				
9806	36,481.2				

Data Detail – Expenditures for Residential Maintenance and Repairs

Source: *Expenditures for Residential Improvements and Repairs, First Quarter 1998, C50/98-Q1, August 1998*, U.S. Department of Commerce, Bureau of the Census.

In Millions of Dollars

Quarter	Expenditures	Fiscal Year	Expenditures
199101	52,600	1992	195,200
199102	48,200	1993	167,700
199103	48,800	1994	168,600
199104	50,300	1995	169,900
199201	41,000	1996	160,100
199202	55,100	1997	145,800
199203	42,900	1998	157,000
199204	41,400		
199301	42,500		
199302	40,900		
199303	41,100		
199304	42,300		
199401	42,600		
199402	42,600		
199403	42,800		
199404	43,500		
199501	40,900		
199502	42,700		
199503	42,800		
199504	41,100		
199601	38,300		
199602	37,900		
199603	34,100		
199604	38,200		
199701	33,200		
199702	40,300		
199703	43,300		
199704	35,300		
199801	39,200		

Fiscal Year 1998 estimated using first quarter 1998 expenditures for second quarter 1998.

**THE LEAGUE OF ARIZONA CITIES AND TOWNS
CONSTRUCTION SALES TAX TASK FORCE REPORT:
AN EVALUATION OF ISSUES; CHALLENGES;
AND OPPORTUNITIES**



APPENDIX 14



STATE OF ARIZONA
EXECUTIVE OFFICE

FIFE SYMINGTON
Governor

April 19, 1995

The Honorable Jane Dee Hull
Secretary of State
1700 West Washington
Phoenix, Arizona 85007

Dear Secretary Hull:

I have today vetoed SB 1206 Contracting Sales Tax.

The legislation proposed to change the way Arizona taxes contracting activities. Currently Arizona generally applies the sales tax to 65% of the value of the contract. The legislation would have provided that sales taxes be applied at the time of acquisition of the materials used in the construction project and the contracting activity would not be taxed.

The proponents of the legislation assert that the current law is complicated and difficult to enforce, and that compliance is somewhat spotty. By taxing materials at the time of purchase, rather than exempting materials and taxing the contracting activity as is now the case, the proponents argue that this legislation should be essentially revenue neutral.

The Department of Revenue and the staff of JLBC have examined the legislation and both entities have independently projected a potential \$50 million (plus) annual revenue loss to the State, with an additional \$20 million or so loss to the cities and towns.

All parties concerned admit that several assumptions must be made in order to calculate impacts. Most importantly, an estimate of the percentage of contract sales price that materials constitute (for the "typical" contract) and the level of noncompliance that currently exists, must be assumed.

Anecdotal evidence exists that can support either position, i.e., that the bill will have/will not have a revenue impact. Both positions can draw on a crude analysis of the percentage of contracts that materials constitute and evidence on the compliance issue.

Jane Dee Hull, Secretary of State
April 19, 1995
Page 2

But the bottom line is no one knows with any degree of certainty what the impact will be. Both sides feel very strongly on this issue.

In considering my course of action on the legislation, I posed this question: is the potential simplification worth the potential revenue loss? In my judgement, given the public policy agenda I wish to pursue (i.e., repealing the income tax), the potential revenue loss outweighs the simplification and the legislation should be rejected.

If better information can be presented on this topic during the interim relative to the revenue loss (that is with respect to the materials and compliance issue), I can reconsider this legislation next year.

Sincerely,

A handwritten signature in black ink, appearing to read "Fife Symington". The signature is fluid and cursive, with a large initial "F" and a long horizontal stroke extending to the right.

Fife Symington
GOVERNOR

FS/ea

Passed the House April 4, 1995
by the following vote: 31 Ayes,

26 Nays, 2 Not Voting,
1 excused

[Signature]
Speaker of the House

Norman L. Moore
Chief Clerk of the House

Passed the Senate February 28, 1995

by the following vote: 17

12 Nays, 1 Not Voting

[Signature]
President of the Senate

[Signature]
Secretary of the Senate

**EXECUTIVE DEPARTMENT OF ARIZONA
OFFICE OF GOVERNOR**

~~This Bill was received by the Governor this~~

~~_____ day of _____, 19____~~

~~at _____ o'clock _____ M.~~

~~_____
Secretary to the Governor~~

APPROVED THIS _____ DAY OF

_____, 19____

at _____ o'clock _____ M.

~~_____
Governor of Arizona~~

**EXECUTIVE DEPARTMENT OF ARIZONA
OFFICE OF SECRETARY OF STATE**

~~This Bill was received by the Secretary of State~~

~~this _____ day of _____, 19____~~

~~at _____ o'clock _____~~

~~_____
Secretary of State~~

SENATE CONCURS IN HOUSE
AMENDMENTS AND FINAL PASSAGE

Passed the Senate April 11, 1995

by the following vote: 20 Ayes,

9 Nays, 1 Not Voting

John Greene
President of the Senate
Charmaine Bellamy
Secretary of the Senate

EXECUTIVE DEPARTMENT OF ARIZONA
OFFICE OF GOVERNOR

This Bill was received by the Governor this

11th day of April, 1995,

at 4:30 o'clock P. M.

Kimberly Insk
Secretary to the Governor

APPROVED THIS _____ day of

_____, 19____,

at _____ o'clock _____ M.

VETOED

Governor of Arizona

EXECUTIVE DEPARTMENT OF ARIZONA
OFFICE OF SECRETARY OF STATE

This Bill was received by the Secretary of State

this _____ day of _____, 19____

at _____ o'clock _____ M.

Secretary of State

S.B. 1206