

CONTRACTING ACTIVITIES

Pub 603

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To better serve you, the Arizona Department of Revenue offers online assistance and filing of your business taxes. To register to use the site and to file your taxes online, go to AZTaxes.gov

This publication is for general information about Arizona transaction privilege tax on contracting activities. The Arizona transaction privilege tax is a tax on the privilege of doing business in Arizona and is not a true sales tax. For complete details, refer to the Arizona Revised Statutes and the Arizona Administrative Code. In case of inconsistency or omission in this publication, the language of the Arizona Revised Statutes and the Arizona Administrative Code will prevail.

Who Must Pay

A prime contractor must obtain a transaction privilege tax license and is subject to transaction privilege tax under the *Prime Contracting Classification*. A prime contractor is a person who supervises, performs or coordinates the *modification* of any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract.

“Maintenance,” “Repair,” “Replacement” and “Alteration” activities (MRRA projects) are excluded from taxation under the Prime Contracting Classification, provided these activities meet the definitions and criteria outlined in the statutes. Income derived from activities that fall within any of MRRA categories is not subject to tax under the Prime Contracting Classification.

What are taxable “**modification**” activities, for purposes of the prime contracting transaction privilege tax? Taxable *modification* activities encompass “ground up” construction, grading and leveling ground, and wreckage or demolition activities, to the extent that they cannot otherwise be characterized as MRRA activities. Projects that do not qualify for MRRA treatment under the statutory thresholds as an “alteration” are also considered taxable modification activities. Modification activities do not include any wreckage or demolition of existing property or any other activity that is a necessary component of a MRRA project, or any mobilization or demobilization related to a MRRA project.

A prime contractor is subject to prime contracting transaction privilege tax on income derived from non-MRRA projects, regardless of whether the contractor furnishes only labor or both labor and materials in the performance of modification work. Prime contractors who perform both modification contracts and MRRA contracts are required to maintain a transaction privilege tax license.

What is the Tax Base for Prime Contractors?

The tax base for the prime contracting classification is 65% of the gross proceeds of sales or gross income derived from the job.

What is the Tax Rate, and How Do I Pay?

The current combined state and county tax rates for contracting activities can be found in the *Arizona State, County and City Transaction Privilege and Other Tax Rate Tables* under business code 015. State and county rates are combined for ease of reporting. City taxes are reported separately.

Factoring Transaction Privilege Tax

When a business “factors” transaction privilege tax, it means the tax is included in the total price rather than shown as a separate charge. If you choose to factor the tax, the tax must be calculated using a factoring formula. There are many different factoring formulas depending on city taxes, county taxes or differences in allowable city tax deductions. See Arizona Transaction Privilege Tax Procedure TPP 00-1 for information about factoring.

Nontaxable Subcontractors

The determination of whether a contractor is a taxable prime contractor or a nontaxable subcontractor depends on the facts surrounding each individual project. An individual contractor can be a taxable prime contractor on one job and a nontaxable subcontractor on the next job.

In order to be a nontaxable subcontractor on an individual project or job, the following factors must be present:

- A. The job is in the control of a prime contractor who supervises, performs or coordinates the construction work and is responsible for the completion of the contract;
- B. The prime contractor receives gross receipts attributable to the job;

- C. The prime contractor is subject to tax on the gross receipts attributable to the job; and
- D. The prime contractor pays the subcontractor out of the taxable gross receipts attributable to the job
- E. The contractor is given a Prime Contractor's Certificate (ADOR Form 5005).

Are Materials Taxed?

The retail tax does not apply to the sale of materials to a taxable prime contractor or a subcontractor if the materials are incorporated into a taxable *modification* construction project.

The retail or rental tax does apply to construction machinery and equipment sold or leased to the contractor for use on a construction job.

How Do Contractors Report Transaction Privilege Tax?

Contractors may elect to report and pay taxes based on either the "cash receipts" or "accrual" method when applying for their transaction privilege tax license. A contractor who elects the cash method reports and pays the tax for the month in which cash payments are actually received. A contractor who elects the accrual method reports and pays the tax for the month in which the income is accrued, without regard to when payment is received.

Application of County Taxes

Prime contractors do not have to pay county taxes on income from contracts entered into before the effective date of a county tax. The contractor, however, must maintain sufficient documentation to verify the date of the contract or written bid.

What Deductions are Allowed?

Deductions available to prime contractors include:

- A deduction for the sales price of land, if it is part of the project, before determining the taxable base. The deduction may not be more than the sales price of the land, not to exceed fair market value.
- A deduction for sales and installation of certain groundwater measuring devices.
- A deduction for the gross income attributable to the purchase of certain equipment that qualifies for exemption under the retail classification.
- A deduction for income derived from activities that fall within any of MRRA categories.

Bonding Requirements

If you are a new or out-of-state contractor, you must submit a bond to cover your future tax liabilities before you can be issued a transaction privilege tax license. See Pub 539 for more information on bonding.

MRRA Projects

The gross income derived from MRRA activities affecting real property are not subject to transaction privilege tax under the *Prime Contracting Classification* when the activities are performed directly for the property owner or authorized party. The Department issued Arizona Transaction Privilege Tax Notice *TPN 15-1* to answer FAQ's from the MRRA perspective. See *Contracting FAQ's*.

FOR ADDITIONAL INFORMATION:

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For additional contracting information contact:

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