

2006 ATRA Outlook Conference

Overview—Arizona and City Transaction Privilege and Use Tax

Presented by

Mike Galloway

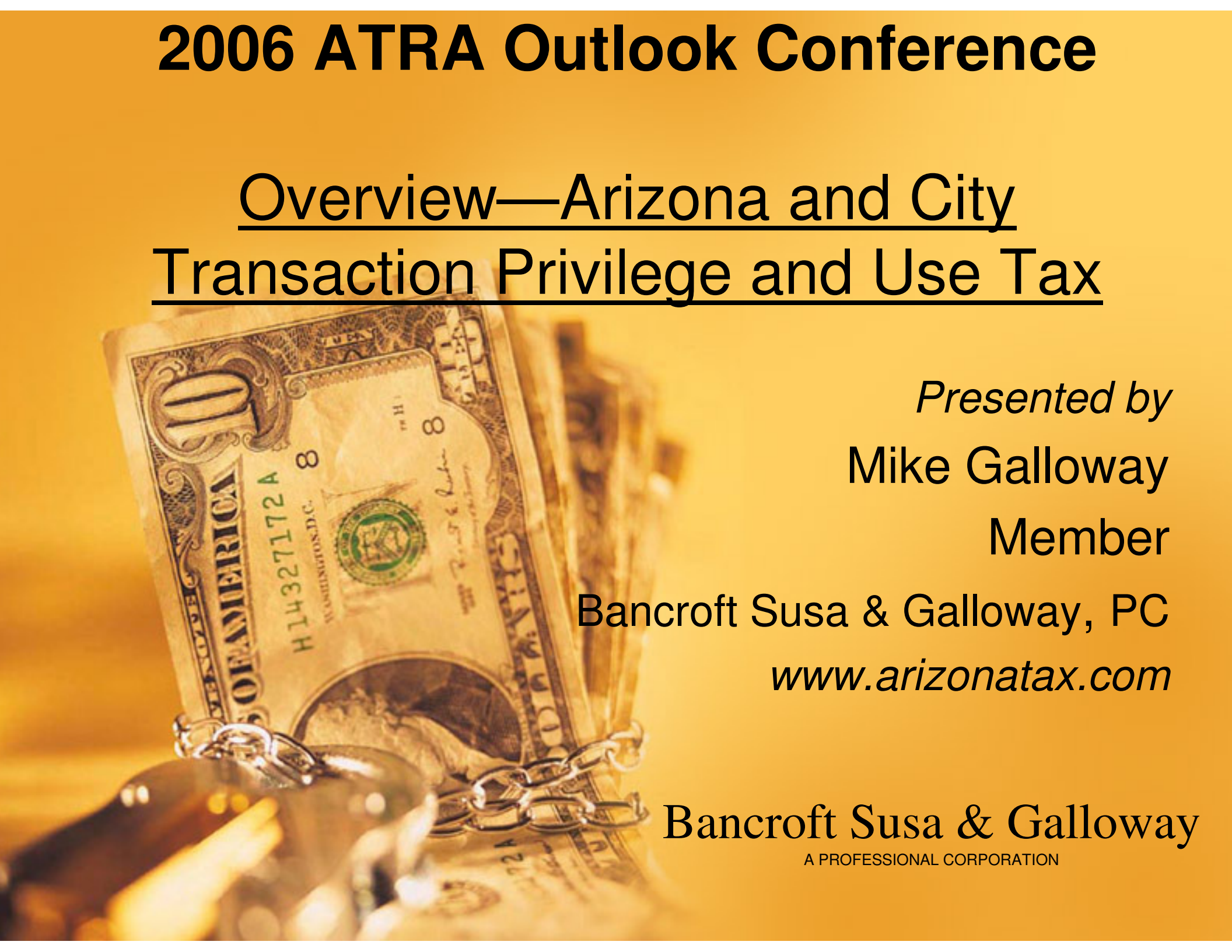
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No More Attorney Jokes!!

Q. What is the difference between Osama Bin Laden and a lawyer?

A. Bin Laden has some good qualities.



Top 10 Reasons Why Lawyers Should Replace Lab Rats



1. There is an endless supply.
2. Lab assistants don't get attached to them.
3. It's more fun to shave and stick needles in lawyers.
4. There are some things rats just won't do.
5. It's fun to dispose of them when you're through.
6. It's not "inhumane" treatment, when it comes to lawyers
7. No one cares when a lawyer squeals.
8. We've seen what happens when they are allowed to breed in the wild.
9. Lawyers belong in cages.
10. Animal rights activists don't care if you torture lawyers.



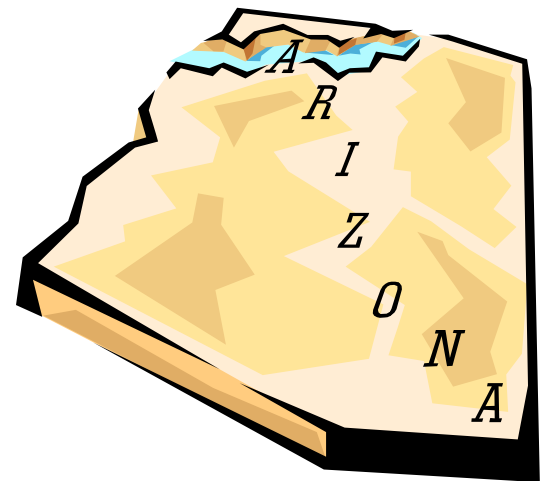
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“Don’t let me face the tax laws alone!”

Overview

- Overview--Arizona and City Privilege Tax
- Overview--Arizona and City Use Tax
- Privilege Tax Facts and Issues
- Streamlined Sales Tax
- Questions



Privilege Tax Overview



- Privilege Taxes are Not Sales Taxes
- They are Taxes for the Privilege of Engaging in Various Types of Business Activities

State Taxable Business Classifications



- Retail Sales
- Transient Lodging
- Transporting
- Personal Property Rental
- Utilities
- Mining (nonmetalliferous)
- Telecommunication
- Amusement
- Publication
- Restaurant
- Job Printing
- (Prime) Contracting
- Pipeline
- Owner Builder
- Private Car Line
- Membership Camping
- Real Property Rental

Privilege Tax Overview

- The Tax is On Gross Income
- There are No Deductions for Expenses, COGS, Salaries, etc.
- There are About 90 “Exemptions” from the Retail Sales Classification
 - Sale for Resale
 - Out of State Sale
 - Services (Beware When Selling Too)
 - The “B” Exemptions



Privilege Tax Overview

- There are Some Other Familiar “Exclusions” From the Contracting Classification
 - 35% “Labor” Deduction
 - Subcontractor Exemption
 - Land Deduction
 - Retail Exemptions
- County Taxes Key on Privilege Taxes



City Privilege Tax Overview

- Most Arizona Cities Have Enacted Similar but Not Identical Privilege Taxes
 - Large Cities Administer Their Programs
- They Are Based on the Model City Tax Code.
- They Function the Same as the State Rules



City Taxable Business Classifications

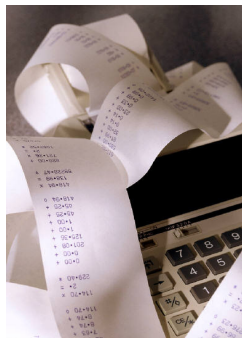


- Advertising
- Advertising – Assignment of Liability (Phoenix)
- Amusements
- Construction Contractors
- **Speculative Builders**
- Owner Builders
- Feed at Wholesale
- Jet Fuel Sales
- Job Printing
- Manufactured Buildings
- Timbering and Other Extraction
- Mining
- Publishing and Periodicals Distribution
- Rental Occupancy
- Hotels
- Rental, Leasing and Licensing of Real Property
- Restaurants and Bars
- Retail Sales
- Telecommunications
- Transporting for Hire
- Utility Services
- Wastewater Removal Services (Phoenix)

City Privilege Tax—The Speculative Builder Tax



- The Spec. Builder Tax is on the Total Sales Price of Newly Constructed Real Estate
- A Credit is Given for All Contracting Tax Paid by the Prime Contractor
 - This Can be Difficult to Determine
- Unpaid Spec. Builder Tax Stays With the Property
- Cities Make Lots of Money with This Tax (Scottsdale—1/3)



City Privilege Tax Overview



- The Model City Tax Code, as Adopted by Each City, has a Huge Series of Model Options and Local Options
 - These Allow Cities to Customize Certain Provisions but Within a Set of Common Parameters
- For Example:

City Privilege Tax Overview



- Under Local Option N, Cities Can Tax or Exempt Land Under the Contracting Tax
- Under Model Option 1, Cities can Tax or Exempt Out of State Residents on In City Purchases

Current Privilege Tax Rates



- The Current State Privilege Tax Rate on Most Activities is 5.6% (5.0 + 0.6)
- County Rates Vary. Maricopa is 0.7% (0.5 (freeways) + 0.2 (jail)). Yuma is 1.5%
- Big City Rates Vary but are Around 2%
 - Phoenix is 1.8%
 - Scottsdale is 1.65%
 - Cave Creek is 2.5%
 - Tucson is 2.0%

Current Privilege Tax Rates

- Other Cities are in the 3% Range
 - El Mirage is 3%
 - Guadalupe is 3%
 - Sedona is 3%
 - Winkelman is 3.5%
 - San Luis is 3.5%
 - The Combined San Luis Rate is 10.60%



Use Tax—State and City



- Use Tax is the Counterpart to the Privilege Tax on Retail Sales (and Utilities)
- If you Avoid Privilege Tax by Purchasing Out of State, You are Liable for Use Tax
- It is Imposed on the Storage, Use or Consumption of the Purchased Property
- The Tax is Based on the Purchase Price (but see Qwest v. ADOR)

Current Issues

- Speculative Builder Tax
- Personal Liability for Collected but Unpaid Privilege Tax
- Pursuing “Speculative Builders”



Streamlined Sales Tax Project

- National Effort To:
 - Simplify and Make Uniform Sales and Use Tax Nationwide
 - Allow for the Use of Modern Technology
 - Permit Taxation of Catalog and Internet Transactions
- Implementing States Approved the Agreement on November 12, 2002



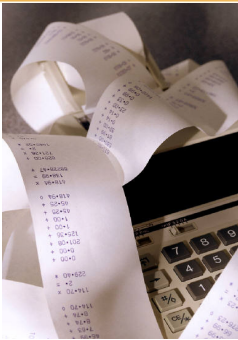
Streamlined Sales Tax Project



- The SSTP Agreement Requires at Least 10 States Representing 20% of the Population of the States that Have a Sales Tax to be in Substantial Compliance Before the Agreement Would Take Effect.
- This Was Achieved a Couple of Years Ago
- **ATTRIBUTES:**

Streamlined Sales Tax Project

- One Point of Administration
 - Local Governments Have No Role
- Single State and Local Tax Base
 - No Different Local Rules
- Uniform Definitions—Food, Clothes, Retail Sale, TPP, Software, etc.
- Rate Simplification
- Uniform Sourcing—Destination Rule



Streamlined Sales Tax Project



- Simplified Exemption Administration
 - Uniform Exemption Certificates
 - Seller Relief for Bad Certificates
- Caps and Thresholds
 - Mostly Phased Out
- Sales Tax Holidays
- Centralized Registration and Amnesty
- Uniform Rules for Recovery of Bad Debts

Streamlined Sales Tax Project

- Technology Models
 - Three Choices
- Uniform Audit Standards and Procedures
- Direct Pay Permits
- One Rounding Rule
- Uniform Tax Returns
- Governance



Streamlined Sales Tax Project

- Federal Legislation
 - No Taxation of Catalog and Internet Sales Without It
- To Date, There Has Been Some Voluntary Compliance by Non Nexus Taxpayers
- Catch 22
- The Politics



Streamlined Sales Tax Project



- Why Arizona Most Likely Will Never be Part of the SSTP:
 - Home Rule State
 - Cities Won't Give Up Nonconforming Taxes
 - Big Cities Won't Give Up Administration of Tax Collection
 - Sourcing Rules Result in Winners and Losers

Questions????



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