



CITY OF TUCSON

A GUIDE TO UNDERSTANDING BUSINESS TAXES AND LICENSES

CONSTRUCTION CONTRACTING BROCHURE: PRIME CONTRACTORS AND SUBCONTRACTORS

This brochure is intended to help prime contractors and subcontractors understand the business privilege (sales) tax laws that apply to their business. This information is based on the City of Tucson Business Privilege Tax Code in effect on October 1, 2011. In case of inconsistency or omission, the Tucson Tax Code will prevail.

WHO IS A CONSTRUCTION CONTRACTOR?

A contractor is any person who builds, improves, adds to, alters, repairs, moves, or demolishes *real property*, either commercial or residential, with or without a written contract. Contractors can do the work personally or through others, and include specialty and *prime contractors*, *subcontractors*, general contractors, speculative builders and owner-builders.

Both speculative builders and owner-builders improve real property that they own; however, speculative builders do so in anticipation of selling it later. Be advised that there are additional tax considerations when a speculative builder sells improved property, which is not addressed in this brochure. (See the Owner Builder & Speculative Builder brochure)

WHAT IS REAL PROPERTY?

Real property basically refers to land and permanent improvements or fixtures to the land.

Improvements or fixtures include things that are physically attached to the land, such as a house or a fence, which are both improvements to the land on which they are built. However, improvements and fixtures also include things that are attached in such a way that they would be expected to be sold along with the land. For example, you would expect to leave the light fixtures in a home you sold because they are attached to the property.

IS A CONSTRUCTION CONTRACTOR RESPONSIBLE FOR THE TAX?

All construction contractors are responsible for the business privilege (sales) taxes due on the total income received for the job. If a construction contractor hires a subcontractor (“sub”) to furnish and install materials, the construction contractor cannot deduct the amount paid to the sub from their total income.

WHAT IS A SUBCONTRACTOR?

A subcontractor is a construction contractor working for another construction contractor, a speculative builder, a seller of new manufactured buildings, or another subcontractor.

To be exempt from tax a subcontractor must obtain a written statement from the responsible party (usually the prime) stating 1) who is liable for the sales tax and 2) the responsible party’s tax license numbers. The City of Tucson accepts the State of Arizona Form 5005, if it is properly completed by the responsible party, as sufficient proof of a subcontractor’s release from sales tax liability. Subcontracting income is exempt from sales tax with this documentation. Documentation must be provided for each project.

WHAT IS THE DIFFERENCE BETWEEN A CONTRACTOR AND A RETAILER?

A **contractor** installs, attaches, or removes materials that do not have an independent functional utility from the real property. Such items include:

- built-in appliances

- carpeting and flooring
- wallpaper and paint
- elevators
- awnings and window film

Services considered contracting include demolition, earthmoving, and wrecking, as well as repair and replacement of items attached to real property.

Note: the rental of earth-moving equipment with an operator is a construction contracting activity.

A **retailer** sells materials, but does not attach them to the real property. The materials sold by a retailer retain an independent functional utility from real property. See the retail brochure for detailed information.

Note: the rental of earth-moving equipment without an operator is a rental of tangible personal property, as is the rental of other types of equipment with or without an operator; these rentals are not an allowable deduction from construction contracting income.

WHAT ARE THE LICENSING REQUIREMENTS FOR A CONTRACTOR?

Every person performing construction contracting whose business is located within the city and every person located outside the city who performs work at locations within the City of Tucson, must obtain a privilege tax license and pay the tax.

Remember: *Job location* determines which jurisdiction shall receive *contracting* tax. *Store location* determines which jurisdiction shall receive *retail* tax.

WHAT IF A CONTRACTOR ONLY DOES REAL PROPERTY SERVICE WORK?

Service work to real property in which no tangible personal property is attached or installed is exempt as a direct customer service activity if the business only does the following types of work. The business would then be required to have a Service License.

Examples include:

- carpet cleaning
- lawn mowing and landscape maintenance
- sewer cleaning
- chimney cleaning

Consumable goods (e.g., lubricants, air conditioning coolant, and faucet washers) incorporated or applied into real property in connection with such services are considered a taxable retail sale of tangible personal property. A retail sales activity code on the business privilege license is necessary to report this income.

SO, SHOULD A CONTRACTOR GET BOTH A BUSINESS PRIVILEGE AND A SERVICE LICENSE?

No. Businesses who perform both contracting and service work can regard a charge to their customer for service labor only to be exempt, and deduct this income from their total taxable income on their City of Tucson business privilege tax return. An example of businesses that may have this deduction would be plumbers when they perform drain cleaning services, or heating and cooling contractors when they inspect a customer's system. Any consumable goods used and charged to the customer in this case would be subject to retail tax, and require the appropriate activity code for retail sales on their business privilege license.

Note: If the work performed involves both labor and materials, other than just consumable goods, total income from the project is taxable contracting income. This applies regardless of whether the contractor or the customer supplies the materials.

HOW DOES SALES TAX APPLY TO A CONTRACTOR?

The City of Tucson Business Privilege Tax Code says that tax is due on the gross income, *less allowable exemptions and deductions*, of "every construction contractor engaging or continuing in the business activity of construction contracting within the City."

Gross income includes all of the gross receipts received from customers. It should include both taxable and nontaxable income. Tax is due either on a cash basis or accrual basis, not at the completion of a contract.

Sources of gross receipts include, but are not limited to, the following:

- Construction of new buildings
- Design and engineering fees
- Parts installed and/or attached to real property
- Labor charges for installing the parts attached to real property
- Labor only charges for work done on real property
- Maintenance or warranty contracts
- Permit fees
- Remodeling of existing buildings

WHAT ARE ALLOWABLE DEDUCTIONS OR EXEMPTIONS FROM GROSS INCOME AVAILABLE TO A CONTRACTOR?

Allowable deductions and exempt income include, but are not limited to:

- Charges related to the installation of groundwater measuring devices
- Income from remediation contracting work
- Out-of-city income
- Income from jobs located on Davis-Monthan Air Force Base
- Subcontracting income, when working for a licensed construction contractor
- Design and engineering fees, if separately stated
- Personal property installed for qualified health care organizations (income from the associated contracting labor is still taxable)
- Income from the sale of income-producing capital equipment (income from the associated contracting labor is still taxable)
- Income (material and contracting labor) from the sale of solar energy devices through December 31, 2016.
- Development or impact fees included in contracts for payment to the state or city government to offset governmental costs of providing public infrastructure, public safety, and other public services to the development.
- Sales tax (separately stated on invoices and in the contractor's records) charged and collected; or, if no tax was separately charged, *factored tax*
- The standard deduction of 35%, calculated after gross income has been reduced by all other exemptions and deductions

WHAT IS FACTORED TAX?

The sales tax for the City of Tucson is a business privilege tax on the seller. This means it is not necessary for the seller to separately state an amount for tax on their billings of goods or services. If an amount for tax is separately stated then that is the amount that must be deducted on the tax reports. Factored tax is the calculated amount of tax that is deducted on the tax reports when tax is not separately stated on billings.

For sales by contractors, the computation is a little more involved, as the total sales price includes the 35% standard deduction allowed to contractors. Therefore, instead of dividing the total sales price by 1 plus the current tax rate (1.091, in the example above), you must first reduce the tax rate by the 35% standard deduction.

Example:

Total sales price, including tax	\$2,350.00
Current tax rate	9.1% (.091)
(State of Arizona - 7.1%, City of Tucson - 2%)	
.091 x 65%	5.915% (.05915)
(9.1% less the 35% standard deduction)	

Computation:

\$2,350.00/1.05915 =	<u>\$2,218.76</u>
	(total sales price less factored tax)
\$2,350.00 - \$2,218.76 =	<u>\$ 131.24</u>
	(factored tax)

Check your calculation and compute the tax due the State of Arizona and the City of Tucson:

Total sales price, including tax **2,350.00 A**
Less: factored tax (from above)- **131.24 B**

Sales price w/o the factored tax **2,218.76 C (A - B)**
Less: 35% (C x .35) **- 776.57 D**
Taxable income **1,442.19 E (C - D)**

Tax due State of AZ (E x 7.1%) **102.40**
Tax due City of Tucson (E x 2%) **+ 28.84**
Total tax due (factored tax) **131.24**

For retail sales, this example is for contractors that also have retail income and want to factor tax. Make sure your income qualifies under retail activity before using this example to factor tax. See the retail brochure for details on retail activity. Take the total sales price of an item that includes the tax, and divide it by 1 plus the current tax rate to find the sales price of the item without the tax. The factored tax (tax due) will be the difference between the total sales price with the tax and the resulting sales price without the tax.

Example:

Total sales price, including tax **\$2,350.00**
Current tax rate **9.1% (.091)**
(State of Arizona-7.1%, City of Tucson-2%)

Computation:

\$2,350.00/1.091 = \$2,153.99
(this is the sales price without the tax)
\$2,350.00 - \$2,153.99 = \$ 196.01
(the \$196.01 is the factored tax)

Check your calculation and compute the tax due the State of Arizona and the City of Tucson:

Total sales price + tax **2,350.00 A**
Less: factored tax **- 196.01 B**
Sales price w/o the tax **2,153.99 C (A - B)**
(taxable income)

Tax due State of Arizona (C x 7.1%) **152.93**
Tax due City of Tucson (C x 2%) **+43.08**
Total tax due (factored tax) **196.01**

FOR MORE INFORMATION ABOUT...

Taxes –Audit Section: City of Tucson – Tax Audit Section - (520) 791-4681
255 W. Alameda - Second Floor,
P.O. Box 27210, Tucson, Arizona , 85726-7210

Licenses –License Section: City of Tucson - License Section - (520) 791-4566
255 W. Alameda - First Floor
P.O. Box 27210, Tucson, Arizona, 85726-7210

Hearing impaired: TDD (520) 791-2639

Visit the City of Tucson Web Page at: <http://www.tucsonaz.gov>

To read more about the business privilege tax: <http://www.tucsonaz.gov/finance/BusInfo.html>

The City of Tucson prepared this brochure. It does not provide comprehensive explanations of Tucson tax laws, rules, or regulations. Specific questions should be addressed to the City of Tucson Tax Audit Section. Rev. 10-11