



CITY OF TUCSON

A GUIDE TO UNDERSTANDING BUSINESS TAXES AND LICENSES

CONSTRUCTION CONTRACTING BROCHURE: OWNER BUILDERS AND SPECULATIVE BUILDERS

This brochure is intended to help owner-builders and speculative builders 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 CONSIDERED A 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, *owner-builders* and *speculative builders*.

WHAT IS REAL PROPERTY?

Real property basically refers to land and 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.

WHAT IS AN OWNER-BUILDER?

An owner-builder is a construction contractor who is also the property owner or tenant in possession of the property. They can do the work themselves or hire others to do the work.

HOW DOES SALES TAX APPLY TO AN OWNER-BUILDER?

An owner-builder is considered to be the ultimate consumer and must pay the privilege tax to all construction contractors hired. They must also pay tax when purchasing from their material suppliers.

If tax was not paid on materials or to a contractor, the owner-builder must compute and pay this tax to the City of Tucson. The tax is due on the twenty-fifth month following the project's *substantial completion*.

Substantial completion means that the structure has passed final inspection or is ready for immediate occupancy or use.

A homeowner's bona fide non-business sale of a family residence is not taxable, if all of the following conditions are met:

1. The home was actually used as the principal place of residence by the family for the six (6) months prior to the offer for sale.
2. The seller has not sold more than two (2) such residences within the three (3) years prior to the offer for sale.
3. The seller has not leased the premises within the two (2) years prior to the offer for sale.

WHAT IS A SPECULATIVE BUILDER?

A speculative builder is an owner-builder who sells, or contracts to sell, **either:**

- a) improved real property, such as custom, model, or inventory homes (regardless of their stage of completion), or improved residential or commercial lots without a structure **at any time;** or
- b) improved commercial real property, other than already specified above, if the transaction takes place **prior to completion or within 24 months of the improvements being substantially complete.**

HOW DOES SALES TAX APPLY TO A SPECULATIVE BUILDER?

Hired contractors need to be informed in writing that the speculative builder will be responsible for the tax upon the sale of the improved property. The speculative builder's City license must also be provided in writing. This can be stated in a contract between the two parties or on an Arizona Department of Revenue Form 5005. Likewise, any construction materials purchased are exempt from tax; the speculative builder should provide an Arizona Department of Revenue Form 5000 to any retailers from which they buy these items.

Taxable income is the selling price of the improved real property less any *allowable deductions*. **Tax due** the City of Tucson is 2% of the taxable income less any *city tax credits*. A speculative builder's tax liability occurs at the close of escrow or transfer of title, whichever is earliest.

Effective May 1, 2010: The tax is due on real property acquired by creditors, when the privilege tax has not been paid by the debtor, at the time the creditor sells the property. The creditor is allowed a tax credit for any tax paid by the debtor.

WHAT ARE ALLOWABLE DEDUCTIONS FROM IMPROVED REAL PROPERTY'S SELLING PRICE?

The deductions allowed to speculative builders include:

- the original purchase price of the land (**land cost**)
- documented **state** sales tax paid to contractors on the project , or to retailers for materials incorporated into the project
- **city** sales tax, either collected on the sale from the customer, or *factored*
- actual direct costs of providing architectural or engineering services
- development or impact fees included in the contract for payment to the state or city government to offset governmental costs of providing public infrastructure, public safety, and other public services to a development
- income derived from a contract to provide and install a solar energy device through December 31, 2016
- the 35% standard deduction for contractors
- partially-improved residential real property sold for resale to another speculative builder, subject to **all** of the following conditions:
 1. The purchaser is a licensed construction contractor with the City of Tucson.
 2. The purchaser provides the seller with a written declaration assuming the liability for all privilege taxes due.
 3. The seller provides the city with a copy of the declaration when taking the exemption on their city business privilege tax return.
 4. The seller maintains adequate records of these resale transactions.

WHAT ARE THE CITY TAX CREDITS ALLOWED TO SPECULATIVE BUILDERS?

The amount of city tax due from sales of improved real property by a speculative builder can be reduced by:

- a) city tax paid to contractors, if the tax was separately itemized in a contract or on progressive billings, and/or
- b) city tax paid to retailers for materials incorporated into the project, if the tax was separately itemized on an invoice.

Note - A city tax credit can only be taken up to the amount of the city tax liability.

WHAT IS FACTORED TAX?

Factored tax is a calculated amount of privilege (sales) tax that is deducted on the city's tax reports when the tax was not separately stated on billings.

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.

Procedure for factoring city tax for a speculative builder sale and computing tax due

Step 1:

Deduct from the selling price, both

- land cost, and
- documented state sales tax

to arrive at a **net selling price**.

Step 2:

Divide this net selling price by 1.013. The result will be the **net selling price without city tax**.

Step 3:

Subtract the result from Step 2, above, from the net selling price (Step 1). The result will be the **factored city tax**.

Step 4:

Multiply the amount from Step 2 by 65%. The result will be **taxable income**. (Alternately, multiply the Step 2 result by 35% to arrive at the **35% standard deduction** for contractors, then subtract the standard deduction from the Step 2 result.)

Step 5:

Multiply **taxable income** (Step 4) by the city tax rate of 2%. The result should match the **factored city tax** amount (Step 3). This is your **city tax liability** before any allowable city tax credits.

Step 6:

Subtract calculated **city tax credit** (see Note) from **city tax liability** (Step 5) to arrive at **city tax due**.

Example

Selling price	\$100,000
Land cost	\$25,000
Total tax paid to contractors (state + city)	\$2,000
Current tax rate	9.1% (.091)
	(State of Arizona – 7.1%, City of Tucson – 2%)

Note - To calculate state & city portions of tax paid to contractors or retailers, use these formulae:

$$\text{State tax}_1 = [(\text{Total tax}) \times (0.071)] / 0.091$$

$$\text{City tax}_2 = [(\text{Total tax}) \times (0.02)] / 0.091$$

Computation

Step 1:

Selling price	\$100,000 A
Less: land cost	<u>-25,000 B</u>
	75,000 C(A – B)
Less: State tax ₁	<u>-1,560.44 D</u>
Net selling price	<u>\$73,439.56 E(C – D)</u>

Step 2:

$$\begin{aligned} \$73,439.56 / 1.013 = & \quad \underline{\underline{\$72,497.10}} \\ & \text{(Net selling price without city tax)} \end{aligned}$$

Step 3:

$$\begin{aligned} \$73,439.56 - \$72,497.10 = & \quad \underline{\underline{\$942.46}} \\ & \text{(Factored city tax)} \end{aligned}$$

Step 4:

\$72,497.10 x 65% = \$47,123.11
(Taxable income)

\$72,497.10 x 35% = \$25,373.99
(35% standard deduction)

Step 5:

\$47,123.11 x 2% = \$942.46
(City tax liability)

Step 6:

[(\$2,000) x (0.02)]/0.091 = \$439.56
(Calculated city tax credit)

\$942.46 - \$439.56 = \$502.90
(City tax due)

STATE OF ARIZONA TAX LIABILITY REGARDING SPECULATIVE BUILDERS' INCOME

The State of Arizona does not have a Code Section in their law regarding speculative builders. It is highly recommended that speculative builders contact the State of Arizona Department of Revenue for further instruction prior to computing their Arizona tax liability. Their local telephone number is (520) 628-6528. Ask to speak to Transaction Privilege Tax Audit.

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