

Owner-Builders and Speculative Builders

This publication is for general information only about **Transaction Privilege (Sales) Tax** on contractors, owner-builders, and speculative builders. For complete details, refer to the **City of Mesa Privilege & Excise Tax Code**, related regulations, & brochures under the Tax & Licensing Department website at www.cityofmesa.org. In case of inconsistency or omission in this newsletter, the language of the Tax Code will prevail.

Who is an Owner-Builder?

An owner or lessor who has improvements constructed on real property is an owner-builder whether he does the work himself or hires others to do the construction.

Are Owner-Builders Taxed?

Owner-builders may or may not be liable for tax. Generally, owner-builders who sell property or who claim exemptions from tax during construction may be liable for tax in addition to tax paid by their contractors. Owner-builders should be aware of the circumstances that will result in a tax liability.

Owners building improvements for their own use

Owner-builders who are building improvements for their own use are not normally the parties liable for the tax on construction contracting. Each of the contractors and suppliers who provide materials and/or services would be liable based on their income from the job. Such owner-builders should not claim a tax exemption from their contractors or suppliers.

Owner builders who are Speculative Builders

A speculative builder is an owner-builder who sells or contracts to sell improved real property:

- Prior to completion of construction, or
- Within 24 months after substantial completion of construction, or
- At any time for custom, model, or inventory homes, or
- At any time for improved residential or commercial lots without a structure

Owner-builders who are constructing improvements for sale may obtain a city sales tax license and claim a tax exemption from their contractors and suppliers. If the owner-builder does not claim an exemption, he may claim a credit for city taxes that have been paid to his contractors and suppliers. An owner-builder who does not sell a property within the applicable 24 month period would owe tax in the 25th month based on the total cost of construction, less a credit for city taxes previously paid to suppliers and contractors.

Sale of a Personal Residence

A homeowner may be exempt from the speculative builder tax if they sell a residence they lived in for the six months prior to the offer for sale. This exemption is subject to some limitations including:

- The seller cannot have sold more than 2 such residences in the past 3 years.
- The property cannot have been rented in the past 2 years.

Tax Rate on Speculative Builders

The Mesa tax rate is 1.75% of the taxable income.

Income and Deductions

- The gross income is the full sales price of the property at the time of close of escrow or transfer of title.
- Taxpayers are allowed to deduct state, county and city sales taxes and impact fees paid from gross income.
- Taxpayers are also allowed the standard 35% deduction. This 35% deduction should be computed after the sales tax deduction has been subtracted.

Credits

The speculative builder tax supplements the tax on construction contracting. The taxpayer is entitled to a credit for the city tax that has already been paid by contractors, suppliers, and developers during the construction.

Owners should retain records of the tax they paid during construction in order to document their credit. They should keep copies of invoices showing that they were charged tax. Many of their contractors may not show the tax as a separate charge on their invoices. Owners should obtain statements from their contractors stating the amount of tax they paid on their income from the project by month to the State & City.

Reporting Your Tax Liability

Speculative builders with a Mesa tax license may report their activity on the same tax return they report other business activities. Those with one-time liabilities or who wish assistance in computing their liabilities may call Tax & Licensing at (480) 644-2051.

Examples

- An investor buys a commercial lot and hires a contractor to build a shopping center on it. He enters into a contract to sell the shopping center 23 months after completion of construction and closes on the sale two months later. He owes tax based on the full sales price less a credit for tax paid by the contractor and the lot developer.
- The above investor does not contract to sell the property until the 25th month after completion. He does not owe any speculative builder tax.
- A homeowner buys a lot and hires various contractors to build a home on it. He does not issue any exemption certificates to anyone. He moves into the house and lives in it for 7 months after completion. He then advertises the house for sale and sells it. He does not owe any speculative builder tax.
- A developer buys a piece of land and subdivides it into ten lots. He has streets and utilities built to the lot lines. He sells five lots to a construction company who provides him with an exemption certificate. He sells one lot per year for five years to individuals to build homes. The first five lots are exempt. The construction company will pay on these later. The remaining five lots are taxable regardless of how long after construction they are sold.
- An owner hires a contractor to build a building. The contractor does not separately charge tax on his invoices. The owner sells the property within 24 months and computes his tax on the sale. The owner would not be able to claim credit for tax paid by the contractor until he could provide evidence that the tax had been paid.

City Rules Differ From State Rules

The Arizona Department of Revenue's laws do not contain the same provisions relating to speculative builders. Owner-builders should contact the Arizona Department of Revenue about the consequences of a sale for purposes of state and county taxes on construction contracting.

Construction Contracting

You Owe Construction Contracting Tax If:

You are in the construction business in the City of Mesa. A contractor is considered to be in business in Mesa when the construction job is in Mesa. Contractors report the income from each job to the Arizona city in which the job is located, not to the city in which the contractor is based. Construction Management income is taxable for the City of Mesa.

What Is Construction Contracting

Construction contracting includes construction, remodeling, repairs, demolition, etc. to real property. There does not have to be a contract for the work. A construction contractor who provides only labor is subject to the same provisions as one who provides both materials and labor.

Are Subcontractors Taxed?

Income from acting as a subcontractor is exempt from the tax. To qualify for this exemption, the subcontractor must obtain the City Privilege License number of the prime contractor plus a written declaration from the prime contractor that he is liable for the tax. The City has exemption certificates available, which you may use to document exemptions such as this. Contractors who work for a property owner, not another contractor or speculative builder will be considered a prime contractor for that job.

Gross Income

Contractors are taxable based on their gross income from the contracting business. Normally this will be either the total amount of the contract or the sales price of the property when it is sold. The income is taxable regardless of whether it includes both labor and materials or just labor. Sales of improved land such as subdivision lots are taxable as contracting. The tax applies when the off-site improvements have been constructed to the property. Contractors may report on a progressive billing basis or on a cash receipt basis. Homebuilders and speculative builders report the total selling price at the time of close of escrow.

Deductions

The following are typical deductions subtracted from the gross income to arrive at the taxable income:

- Exempt subcontracting.
- Environmental/Remediation contracting.
- Sales tax collected is deductible. If you have charged your customer sales tax separately, and it is included in gross income, you may deduct it. If you have not charged your customer sales tax, you may "factor" your sales tax. This means that the total contract price includes sales tax and you can compute the amount of tax and deduct it.
- A standard 35% deduction is allowed for all income taxable as contracting. This is in lieu of an actual labor deduction. This 35% should be computed after the sales tax deduction has been deducted.
- Out of City contracting.
- No land deduction is allowed.
- Development or impact fees included in a construction or development contract for payment to the state or local government to offset governmental costs of providing public infrastructure, public safety and other public services to a development.

Exemptions Available For Items You Purchase

There is an exemption from the tax on retail sales for materials, which a contractor purchases for incorporation into a building or improvement. This does not apply to construction equipment and tools sold or leased to a contractor. It does not apply to any other tangible personal property, which is not incorporated into the actual improvements being built. It does not apply to materials purchased directly by an owner-builder.