



CONSTRUCTION CONTRACTORS, OWNER BUILDERS AND SPECULATIVE BUILDERS

Chandler Transaction Privilege (Sales) & Use Tax

This serves as general information only. For complete details, please refer to the City of Chandler Tax Code.

June 2013

YOU MAY OWE CONSTRUCTION CONTRACTING TAX IF:

You are in the construction business in the City of Chandler. A contractor is considered to be in business in Chandler when the construction job is located in Chandler. Contractors report the income from each job to the Arizona city **in which the job is located**, not to the city where the contractor is based. (See Sec. 62-415)

TAX RATE ON CONSTRUCTION CONTRACTING

The Chandler tax rate is 1.5% of the taxable income.

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. (See Sec. 62-100)

Examples of taxable contracting activity include:

- Construction or demolition of a building
- Road construction
- Land excavation and landscaping
- Installation of permanently attached equipment or fixtures to real property

- Sales and installation of floor covering
- Home remodeling
- Repairs to a building
- Construction for a government agency (including work for the City of Chandler)
- Construction for a church or nonprofit organization

Examples of items that are not considered construction contracting:

- Landscape maintenance, lawn mowing (exempt service)
- Installation of drapes and miniblinds (retail)
- Plug-in kitchen equipment (retail)
- Tangible personal property included in a construction contract that would otherwise be exempt if purchased by the specified entity (e.g., non-profit qualified healthcare providers).

ARE SUBCONTRACTORS TAXED?

Income from acting as a subcontractor may be exempt from the tax. To qualify for this exemption, the subcontractor must obtain a Declaration, including the City Privilege License number of the owner-builder/speculative builder or construction contractor, stating that they are liable for the tax. Contractors who work for a property owner, not another contractor or speculative builder, will be considered to be a contractor for the job and responsible for the related tax.

ARE OWNER-BUILDERS TAXED?

An Owner-Builder means an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs or has reconstructed any improvement to real property.

Owners who are improving real property for themselves may or may not be the party liable for paying the tax on the construction.

A homeowner who is building his own principal residence would not normally be the liable party. Each of the contractors or suppliers who provide materials and/or services would be liable based on their income from the job. However, the owner may be liable for some additional tax if the property is offered for sale or sold prior to occupying the home for at least six (6) months. (See Reg. 62-416.1)

An Owner-Builder can become a Speculative Builder and subject to tax based on the sales price of the real property (See Sec. 62-416). A Speculative Builder is defined as (See Sec. 62-100):

An "Owner-Builder" who sells or contracts to sell, at any time, improved real property consisting of:

- A) custom, model, or inventory homes regardless of the stage of completion of such homes; or
- B) improved residential or commercial lots without a structure, or

An Owner-Builder who sells or contracts to sell improved real property, other than real property specified in (A) and (B) above:

- A) prior to completion; or
- B) before the expiration of twenty-four (24) months after the improvements of the real property sold are substantially complete.

An owner-builder who sells or contracts to sell a commercial structure before the expiration of twenty-four (24) months, after the improvements are substantially complete, would be liable for tax based on the property's sale price. If the property is not sold within 24 months of the date it was completed, the tax would be due on the 25th month following completion and would be based on the gross income realized by those contractors to whom the owner-builder provided a written declaration that they were not responsible for the tax. (See Sec. 62-417)

GROSS INCOME

Contractors and Speculative Builders 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 real property, such as subdivision lots, are taxable as Speculative Builder Sales.

Contractors may report on a progressive billing basis or on a cash receipt basis. Speculative builders report the total selling price at the time of close of escrow or transfer of title, whichever occurs first.

The City of Chandler does not acknowledge artificially contrived transactions or sales that do not reflect the fair market value of the property transferred. Sales to a "Marketing Arm" would be taxed at the final sales price to the actual consumer or the fair market value of the property transferred; whichever is higher. (See Sec. 62-210 & 62-220)

EXEMPTIONS AVAILABLE FOR ITEMS YOU PURCHASE

There is an exemption from the tax on retail sales for materials which a contractor or speculative builder purchases for incorporation into a building or improvement. This exemption does not apply to:

- Furniture, construction equipment or tools sold or leased to a contractor or speculative builder.
- Any other tangible personal property that is not incorporated into the actual improvements.
- Materials purchased directly by an owner-builder, who is not a speculative builder.

DEDUCTIONS, EXCLUSIONS & EXEMPTIONS

The following are examples of deductions, exclusions and exemptions that are subtracted from gross income to arrive at the taxable income:

- Actual direct costs of architectural & engineering fees
- Development fees included in a construction or development contract
- Qualified solar energy device
- Privilege Tax collected
- 35 percent standard deduction
- Exempt subcontracting
- Out-of-City contracting
- Installation, assembly, repair or maintenance of income-producing capital equipment
- Installation, assembly, repair or maintenance of clean rooms

If you have charged your customer Transaction Privilege Tax separately, and it is included in gross income, you may deduct the tax. If charging tax separately, the combined State, County and City tax rate of 7.8% can be computed on the taxable amount.

If you have not separately charged your customer Transaction Privilege Tax, you may “factor” your Privilege Tax. This means that the total contract price includes the Transaction Privilege Tax, and you can compute the amount of tax and take it as a deduction. NOTE: These factors change based on any changes to the combined state, county and city tax rate. Make sure you use the factor that corresponds to the tax rate in effect for your transaction. Computer spreadsheet templates are also available on our website.

A standard 35% deduction is allowed for all income taxable as contracting. The 35% standard deduction should be computed after all other deductions, exclusions and exemptions are taken.

The City of Chandler does not allow a land deduction.

TAX CREDIT

The following tax credits are available to owner-builders or speculative builders, not to exceed the tax liability against which such credits apply, provided such credits are documented to the satisfaction of the Tax Collector:

- (A) A tax credit equal to the amount of City Privilege or Use Tax, or the equivalent excise tax, paid directly to a taxing jurisdiction or as a separately itemized charge paid directly to the vendor with respect to the tangible personal property incorporated into the said structure or improvement to real property undertaken by the owner-builder or speculative builder.
- (B) A tax credit equal to the amount of Privilege Taxes paid to this City, or charged separately to the speculative builder, by a construction contractor, on the gross income derived by said person from the construction of any improvement to the real property.
- (C) No credits provided herein may be claimed until such time that the gross income against which said credits apply is reported.

Tax credit will not be allowed unless detailed on Schedule B on Page 2 of the Transaction Privilege & Use Tax Return **and** supporting documentation attached.

Tax credit cannot be taken by a construction contractor as an offset to the tax due on construction contracting receipts or draws. It is the responsibility of the construction contractor

to acquire materials incorporated into the project tax exempt and to properly exempt subcontractors.

ACQUISITIONS OF REAL PROPERTY, INCLUDING FORECLOSURES, ON WHICH TAX HAS NOT BEEN PAID

Code Section 595(c) provides that:

Any person who purchases, or who acquires by foreclosure, by sale under trust deed or warranty deed in lieu of foreclosure, or by any other method, improved real property or a portion of improved real property for which the Transaction Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder or owner builder, as provided in Sections 416 and 417.

- (1) Any person who is a creditor or an affiliate of creditor, who acquires improved real property directly or indirectly from the creditor's debtor by any means set forth in this subsection, shall pay the tax based on the amount received by the creditor or its affiliate in a subsequent sale of such improved real property to a party unrelated to the creditor, regardless of when such subsequent sale takes place. Such tax shall be due in the month following the month in which the sale of the improved real property by the creditor or its affiliate occurs. Notwithstanding the foregoing, if the real property meets the definition of partially improved residential real property in Section 416(a)(4) and all of the requirements of Section 416(b)(4) are met by the parties to the subsequent sale transaction, then the tax shall not apply to the subsequent sale.
- (2) In the event a creditor or its affiliate uses the acquired improved real property for any business purpose, other than operating the property in the manner in which it was operated, or was intended to be operated, before the acquisition or in any other manner unrelated to selling the property, the tax shall be due. The gross income upon which the tax shall be determined pursuant to Sections 416 and 417 shall be the fair market value of the improved real property as of the date of acquisition. The tax shall be due in the month following the month in which such first business use occurs. When applicable, the credit bid shall be deemed to be the fair market value of the property as of the date of acquisition.
- (3) Once the subsequent sale by the creditor or its affiliate has occurred and the creditor or its affiliate has paid the tax due from it pursuant to this subsection, neither the creditor nor its affiliate, nor any future owner, shall be liable for any outstanding tax, penalties or interest that may continue to be due from the debtor based on the transfer from the debtor to the creditor or its affiliate.
- (4) If the tax liability imposed by either Section 416 or Section 417 on the transfer of the improved real property to the creditor or its affiliate, or any part thereof, is paid to the Tax Collector by the debtor subsequent to the payment of the tax by the creditor or its affiliate, the amount so paid may constitute a credit, as equitably determined by the Tax Collector in good faith, against the tax imposed on the creditor or its affiliate by either paragraph 1 or paragraph 2 of this subsection.
- (5) Notwithstanding anything in this Chapter to the contrary, if a creditor or its affiliate is subject to tax as described in paragraph 1 or paragraph 2 of this subsection and such

creditor or affiliate has not previously been required to be licensed, such creditor or affiliate shall become licensed no later than the date on which the tax is due.

Section(s) 416 and 417 relate to the tax imposed on the owner-builder of improved real property. Examples would be speculative homes, model homes, commercial buildings and improved lots, where the owner-builder was responsible for the tax imposed under these sections, but did not pay the tax. The party acquiring the property could be responsible for the unpaid tax.