



Beware of Arizona's Local Speculative Builder Tax

This month's state and local tax (SALT) column addresses Arizona's speculative builder tax, a local privilege tax that operates like a stealth real estate transfer tax and that many taxpayers do not even learn about until they hear from a tax auditor.

Some states have a real estate transfer tax that is well known to real estate professionals and routinely accounted for by escrow agents on settlement statements, but the State of Arizona does not impose anything like a real estate transfer tax.

However, Arizona cities and towns impose a privilege (sales) tax on speculative builders that operates much like a real estate transfer tax in some situations. Unfortunately, however, Arizona's local speculative builder taxes are not well known to real estate developers and professionals and, as a result, are not routinely accounted for by escrow agents on settlement statements. Rather, many taxpayers do not even learn about Arizona's local speculative builder taxes until they hear from a tax auditor after a property changes hands.

What is Speculative Builder Tax?

Speculative builder tax applies to 65 percent of the total selling price from the sale of "improved real property," after taking into account all available exclusions, deductions, exemptions, and credits. Currently, speculative builder tax rates vary from 1.5 percent to 5.0 percent, so tax liabilities can be significant — especially if the taxpayer did not consider the tax before agreeing to the economic terms concerning the sale of the property.

The Tax Only Applies to Sales of Improved Real Property

Fortunately, the tax does not apply to sales of unimproved real property; it only applies to sales of improved real property. However, it does not take much to be classified as "improved real property," which is defined for purposes of this tax as any real property "(A) upon which a structure has been constructed; or (B) where improvements have been made to land containing no structure (such as paving or landscaping); or (C) which has been reconstructed as provided by Regulation; or (D) where water, power, and streets have been constructed to the property line."

Who is Liable for the Tax?

The tax is imposed on "speculative builders," which are defined as "owner-builders" who either sell or contract to sell: (1) at any time — one or more homes, regardless of the state of completion, or improved residential or commercial lots without a structure; or (2) improved real property other than that specified above prior to completion or before the expiration of 24 months after the improvements to the property sold are substantially complete.

"Owner-builder" is defined as "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."



by James G. Busby, Jr., CPA

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For purposes of this tax, “substantially complete means the construction contracting or reconstruction contracting: (1) has passed final inspection or its equivalent; or (2) certificate of occupancy or its equivalent has been issued; or (3) is ready for immediate occupancy or use.”

Municipalities generally only attempt to impose speculative builder tax on the first sale of a property after it is substantially complete. But, to postpone the tax liability on residential lots or partially completed residential properties until substantial completion of the home, the buyer must provide an appropriate exemption certificate.

The incidence of speculative builder tax is on the speculative builder/seller. However, any person who purchases or acquires — by foreclosure, by sale under trust deed or warranty deed in lieu of foreclosure, or by any other means — improved real property upon which speculative builder tax has not been paid may become liable for the tax. ■