

Beware of Arizona's Local Speculative Builder Tax

by James G. Busby Jr.



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In this article, Busby discusses Arizona's speculative builder tax, a local privilege tax that operates like a stealth real estate transfer tax and that many taxpayers do not learn about until they hear from a local tax auditor.

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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 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, the state'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 their local 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.¹ Speculative builder tax rates vary from 1.5 percent to 5 percent, so tax liabilities can be

¹Model City Tax Code (MCTC) section __-416. Each municipality selects from among various optional exclusions and exemptions and adapts its own version of the MCTC under a particular chapter of their

(Footnote continued in next column.)

significant — especially if the taxpayer did not consider the tax before agreeing to the economic terms concerning the sale of the property.

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.²

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:

- at any time — one or more homes, regardless of the state of completion, or improved residential or commercial lots without a structure; or
- improved real property other than that specified above before completion or before the expiration of 24 months after the improvements to the property sold are substantially complete.³

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."⁴

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

city code. The chapter number for the tax code varies by municipality, but the speculative builder tax is always codified in section 416 of any particular municipality's tax code.

²MCTC section __- 416(a)(2).

³MCTC section __- 100.

⁴*Id.*

issued; or
(3) is ready for immediate occupancy or use.”⁵

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 or 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 be liable for the tax.⁶

Exclusions, Exemptions, Deductions, and Credits

At a minimum, the local speculative builder tax’s applicability should be taken into consideration before one sells improved real property in Arizona. Then, if the tax applies, one should consider whether one qualifies for any exclusions, exemptions, deductions, or credits.

Two credits against the tax — available in all municipalities — reduce one’s speculative builder tax liability dollar-for-dollar. One credit is for the amount of municipal sales or

use tax paid directly to a tax jurisdiction or as a separately itemized charge paid directly to the vendor for tangible personal property incorporated into the structure or improvement by the speculative builder. The other credit is for sales tax paid to the municipality, or charged separately to the speculative builder, by a construction contractor on its gross income from the construction of the improvements to the property.⁷

Various exclusions, exemptions, and deductions are available, but vary by municipality.⁸ Common exclusions, exemptions, and deductions will be described in an upcoming column.

Practice Tips

Tax professionals who work for or consult with individuals or businesses that develop and sell, or that purchase, improved real property should help them determine whether Arizona’s local speculative builder tax applies to their transactions. Sometimes legally planning around this tax simply involves temporarily postponing sales of some types of property. On other occasions, just taking the tax into consideration before agreeing to the economic terms concerning the sale of a property is all one can do. ☆

⁵*Id.*

⁶MCTC section __- 595.

⁷MCTC section __- 416(c)(3).

⁸MCTC section __- 416.