

Common Ways to Limit the Impact of Arizona's Speculative Builder Tax

by James G. Busby Jr.



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In this article, Busby highlights common ways to limit the impact of Arizona's speculative builder tax through the use of exclusions, exemptions, deductions, and more.

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Arizona cities and towns impose a privilege (sales) tax on speculative builders that operates much like a real estate transfer tax in some situations.¹ However, as often is the case with other sales taxes, there are opportunities to limit the impact of Arizona's speculative builder tax. Many of those opportunities require planning ahead, as well as obtaining and maintaining copies of appropriate documentation — often including exemption certificates.

Definitional Limitations

This local speculative builder tax applies only to sales of “improved real property” by “speculative builders.”² As I explained in my column last month,³ sometimes legally planning around this tax simply involves postponing sales of

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

²MCTC section __-416(a).

³Busby, “Beware of Arizona's Local Speculative Builder Tax,” *State Tax Notes*, Mar. 14, 2016, p. 815.

some types of property for a short time in order to avoid falling within the scope of those key terms.

Tax Credits and Cost Shifting

When the tax does apply, it applies to 65 percent of the total selling price from the sale of the subject property, after taking into account all available exclusions, deductions, exemptions, and credits.⁴

The dollar-for-dollar tax credits identified in my column last month are often the most direct way to limit the amount of tax due. And speculative builders who are aware of the tax can try to pass the cost of tax along to the party who purchases the property from them.

Exclusions

While the definitional limitations, tax credits, and the idea of passing the cost of the tax along to one's buyer, if possible, apply in all Arizona cities and towns that impose speculative builder tax, exclusions from the tax vary by jurisdiction.

For example, five cities and towns allow speculative builders to exclude the cost of land from their tax base, and 17 cities and towns allow speculative builders to exclude the fair market value of land from their tax base, but most Arizona cities and towns that impose speculative builder tax do not allow speculative either of these exclusions.

One common exclusion available in all jurisdictions allows speculative builders that obtain the appropriate exemption certificate to shift the tax liability on residential lots or partially completed residential properties until substantial completion of the home.⁵

Other common exclusions that are available in all jurisdictions allow speculative builders to exclude the “direct costs” of providing architectural or engineering services⁶ and to exclude the “prior value” of a property in cases of “reconstruction.”⁷

⁴MCTC section __-416.

⁵MCTC section __-416(b)(4).

⁶MCTC section __-416(b)(5).

⁷MCTC section __-416(b)(1).

The city of Sierra Vista adapted a special exclusion for transactions located at Fort Huachuca.⁸

Exemptions

The most commonly used exemptions are for:

- the cost of “income producing capital equipment” and tangible personal property used at a qualifying non-profit hospital, community health center, or health-care organization that is exempt or deductible from the municipal sales tax base for retailers;⁹ and
- amounts attributable to development fees that are incurred in relation to the construction, development, or improvement of real property.¹⁰

Exemptions are also available for contracts regarding:

- the construction of environmentally controlled facilities to raise poultry for the production of eggs;¹¹
- the installation, assembly, repair, or maintenance of cleanrooms that are deducted from the municipal sales tax base for retailers;¹² and
- some activities for persons engaged in activities regarding livestock, livestock products, crops, or crop products if the project is directly and primarily to prevent, monitor, control, or reduce air, water, or land pollution.¹³

Deductions

Arizona cities and towns allow just three deductions from the speculative builder tax:

- 35 percent of all amounts subject to tax (hence, the 65 percent tax base);¹⁴
- proceeds from installing, assembling, repairing, or maintaining income-producing capital equipment that is deducted from the municipal sales tax base for retailers so long as the equipment does not become permanently attached to realty or a manufactured building;¹⁵ and
- proceeds from a contract to provide and install a qualified solar energy device.¹⁶

Practice Tip

Speculative builders that enter into a contract to sell a property with one or more tenants in place may be able to reduce their tax base further by taking into account the portion of the sales price attributable to one or more leases that are in effect. ☆

⁸Sierra Vista City Code section 8A-416(b)(3).

⁹MCTC section __-416(c)(1)(A)(i).

¹⁰MCTC section __-416(c)(1)(E).

¹¹MCTC section __-416(c)(1)(B).

¹²MCTC section __-416(c)(1)(C).

¹³MCTC section __-416(c)(1)(D).

¹⁴MCTC section __-416(c)(2)(A).

¹⁵MCTC section __-416(c)(2)(B).

¹⁶MCTC section __-416(c)(2)(C).

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