

CONSTRUCTION CONTRACTING

YOU OWE TAX ON CONSTRUCTION CONTRACTING IF:

You are in the construction business in the city of Prescott. A contractor is considered to be in business in Prescott when the construction job is in Prescott. 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.

TAX RATE ON CONSTRUCTION CONTRACTING

The city tax rate on construction contracting is 2% of 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.

Examples of taxable contracting activities include:

- Construction or demolition of a building
- Road construction
- Land excavation and landscaping
- Installation of permanently attached equipment
- Sales and installation of floor coverings
- Off-site improvements
- Home remodeling
- Repairs to a building
- Construction for a government agency
- Construction for a church or nonprofit organization

Examples of items not considered construction contracting:

- Landscape maintenance, lawn mowing and pruning.
- Plug-in kitchen equipment (retail)

ARE SUBCONTRACTORS TAXED?

Subcontracting income is exempt from tax. To qualify for this exemption, the subcontractor must obtain the City Privilege Tax License number from the prime contractor in addition to a written declaration from the prime contractor stating that he (the prime) is responsible 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, other than a speculative builder, will be considered a prime contractor for that job.

ARE OWNER-BUILDERS TAXED?

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.

A "speculative builder" who is building a home or other property for sale would be liable for tax based on the property's sales price. If the property is not sold within 24 months of the date it was completed, the tax would be due based on the cost of construction. The tax on a home in a home builders' inventory is not due until the home is sold, even if it exceeds 24 months.

Other owner-builders who are building for their own use would not normally be liable for the tax. Their contractors and suppliers would be the liable parties. However, the owner may be liable for some additional tax if he sells the property within 24 months after completion.

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.

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.

DEDUCTIONS

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

- Fair market value of land if included in gross income (speculative builders)
- Exempt subcontracting
- Out-of-City contracting
- Privilege tax collected. If you have charged your customer tax separately, and it is included in reported gross income, you may deduct it.

Speculative builders are allowed a land deduction at the fair market value. In lieu of documented fair market value, a deduction of 20% of the gross selling price is allowed.

If you have not charged your customer privilege tax, you may "factor" your tax. This means that the total contract price includes tax and you can compute the amount of tax and deduct it. Formulas for factoring tax are included below.

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 land (if applicable) and privilege tax deduction have been taken.

FACTORING PRIVILEGE TAX

If tax has been neither separately charged nor separately collected, factoring of tax is allowed in computing taxable income.

When reporting income, the total sales price should be reported as the gross. Deductions, if applicable, can be taken in the following areas and in the following order.

1. Subcontracting
2. Out-of-city contracting
3. Fair market value of land if included in gross (if not documented, 20% of sales price)
4. Factored tax. The deduction for tax included in the contract price is computed by multiplying the total price less the deductions above by .05148088. This factor is for contracting activity subject to the 5.6% State tax, the .75% Yavapai County tax as well as the 2% City of Prescott tax. (Factors will vary depending on city and county tax rate.)

For Example:

Sales Price (includes land)	\$100,000.00
Less:	
Land	20,000.00
Factored Tax	4118.47
35% Contractor's Ded	<u>26,558.54</u>
Taxable Amount	<u>\$49,322.99</u>

x 2% City Tax Due	\$986.46
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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 that he will sell and remit tax on. 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, nor does it apply to materials purchased directly by an owner-builder.



**City of Prescott
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Tax & Licensing Division
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For more information contact:

- 928 777-1268 Taxpayer Assistance Rep
- 928 777-1210 Privilege Tax Auditor
- 928 777-1231 Tax & Licensing Supervisor

PRESCOTT PRIVILEGE TAX

CONSTRUCTION CONTRACTING



This publication is for general information regarding Transaction Privilege (Sales) Tax on construction contracting. For complete details, refer to the City of Prescott Privilege & Use Tax Code and related regulations. In the case of an inconsistency or omission in this publication, the language of the Tax Code will prevail. The transaction privilege tax is commonly referred to as a sales tax, however, under State of Arizona law, the tax is on the privilege of doing business in Prescott and is not a true sales tax.

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