

## SALES OF IMPROVED REAL PROPERTY

The current tax rate in the City of Prescott on the taxable income of speculative builders is 2%<sup>1</sup>. This is assessed on the sales price of the improved property less the applicable exclusions, exemptions, deductions, and credits.

### **An owner-builder is defined as:**<sup>2</sup>

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.

### **A speculative builder is defined as either:**<sup>2</sup>

1. An owner-builder who sells or contracts to sell, at anytime, improved real property consisting of:
  - Custom, model, or inventory homes, regardless of the stage of completion; or
  - Improved residential or commercial lots without a structure.
2. An owner-builder who sells or contracts to sell improved real property other than improved real property specified above:
  - Prior to completion; or
  - Before the expiration of 24 months after the improvements of the real property sold are substantially complete.

### **A spec. build's possible exclusions, exemptions, deductions, and credits are:**

- Fair Market Value of Land.<sup>3</sup> This may be determined by the greater of:

<sup>1</sup> Sec. 4-1-416(a)

<sup>2</sup> Sec. 4-1-100

<sup>3</sup> Sec. 4-1-416(b)(2)

- 20% of the sales price of the improved real property, or
- FMV of the land by appraisal, if the appraisal was completed prior to the close of escrow, or
- Cost of the land when first purchased.

- Direct (actual) costs of architectural or engineering services that are incorporated into the contract.<sup>4</sup>

- Development fees<sup>5</sup> related to the construction, development, or improvement of the real property are limited by the:

- Value of development fees actually imposed.
- Actual amount of development fees paid.
- Currently these would include impact and development fees such as the following:
  - Fire Impact Fee
  - Library Impact Fee
  - Parks Impact Fee
  - Police Impact Fee
  - Public Works – Impact Fees
  - Public Works – Water Resource Development Fee

- 35% standard deduction.<sup>6</sup>

- Factored tax deduction.<sup>7</sup>

- Tax credit for City tax paid on materials incorporated into the improved real property or separately charged by a construction contractor.<sup>8</sup>

- There are other less common exclusions, exemptions, and deductions that may relate to a spec. sale such as: reconstruction

<sup>4</sup> Sec. 4-1-416(b)(5)

<sup>5</sup> Sec. 4-1-416(c)(1)(E)

<sup>6</sup> Sec. 4-1-416(c)(2)(A)

<sup>7</sup> Sec. 4-1-250

<sup>8</sup> Sec. 4-1-416(c)(3)

contracting,<sup>9</sup> sales to other speculative builders,<sup>10</sup> machinery, equipment, or other tangible personal property already exempt,<sup>11</sup> construction of environmentally controlled poultry facilities,<sup>12</sup> cleanrooms,<sup>13</sup> commercial production of livestock and agricultural products,<sup>14</sup> construction related to income producing capital equipment,<sup>15</sup> and installation of solar energy devices.<sup>16</sup>

### **Exceptions:**

A homeowner's bona fide non-business sale of a family residence:<sup>17</sup>

- If all of the following conditions are met the sale is not taxable:
  - Used as principal residence or vacation residence by immediate family of the seller for 6 months prior to the offer for sale.
  - Seller has not sold more than 2 such homes within 36 months prior to the offer for sale.
  - The home was not leased or rented for any period within 24 months prior to the offer for sale.

### **Examples:**

1. XYZ LLC owns a piece of real property and constructs a custom home. They will be liable for tax as a speculative builder upon sale of the home. The 24 month time frame **does not** apply.
2. If an individual constructs a custom home and lives in it for at least 6 months prior to the offer for sale, has not sold more than 2 such homes in the previous 36 months,

<sup>9</sup> Sec. 4-1-416(b)(1)

<sup>10</sup> Sec. 4-1-416(b)(4)

<sup>11</sup> Sec. 4-1-416(c)(1)(A)

<sup>12</sup> Sec. 4-1-416(c)(1)(B)

<sup>13</sup> Sec. 4-1-416(c)(1)(C)

<sup>14</sup> Sec. 4-1-416(c)(1)(D)

<sup>15</sup> Sec. 4-1-416(c)(2)(B)

<sup>16</sup> Sec. 4-1-416(c)(2)(C)

<sup>17</sup> Reg. 4-1-416.1

and did not lease or rent the home, they will be exempt from this tax under the provision of a homeowner's bona fide non-business sale of a family residence.

3. XYZ LLC constructs a multi-family residential structure and sells it within 24 months after the issuance of a Certificate of Occupancy; they would be liable for tax as a speculative builder.
4. If XYZ LLC constructs property as in #3 above, but does not enter into a contract to sell the property within 24 months of the date of completion, the tax would be due on the 25<sup>th</sup> month following completion and would be based on the gross income realized by those contractors to whom XYZ LLC provided a written declaration that they were not responsible for the tax.
5. ABC, Inc. owns a piece of commercial land and constructs a shopping center. ABC, Inc. then sells the property within 24 months from the issuance of a Certificate of Occupancy. They would now be liable for tax as a speculative builder.
6. If ABC, Inc. constructs property as in #5 above, but does not enter into a contract to sell the property within 24 months of the date of completion, tax would be due on the 25<sup>th</sup> month following completion and tax would be based on the gross income realized by those contractors to whom ABC LLC provided a written declaration that they were not responsible for tax on the construction of the improved real property.

To view a complete copy of the City tax code, please go to: <http://www.prescott-az.gov>



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# PRESCOTT PRIVILEGE TAX

## SALES OF IMPROVED REAL PROPERTY



This publication is for general information regarding Transaction Privilege (Sales) Tax on sales of improved property by speculative builders. 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.