

**LET'S MAKE IT EVEN MORE COMPLICATED:  
City Sales Taxation Of Contracting And  
The Differences From The State**

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1. *Construction Management Services Are Taxable At The City Level.*

The state statute definition of a prime contractor does not include Construction Manager services. In fact, the state statute expressly defines a prime contractor to be an entity that is responsible for completion of the project, which inherently excludes many construction managers. The Model City Tax Code, on the other hand, more broadly defines its scope. It says:

“Construction Contractor” means a person who undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement to real property, or to do any part thereof. “Construction Contractor” includes subcontractors, specialty contractors, prime contractors, and any person receiving consideration for the general supervision and/or coordination of such a construction project except for remediation contracting. This definition shall govern without regard to whether or not the construction contractor is acting in fulfillment of a contract.

2. *Land Deduction.*

The state statute recognizes that the value of the land can be deducted from the tax base of a prime contractor. The Model City Tax Code only includes that deduction as a Local Option:

**++(Local Option #M:**

(2) Cost of land. Gross income from the sale or improved real property shall not include the seller’s original purchase price of the land which is included in the real property sold, when a charge for such land is included in the total selling price of the real property sold.)++

**OR**

**++(Local Option #N:**

(2) Fair market value of land. Gross income from the sale of improved real property shall not include the “fair market value” of the land which is included in the real

property sold, when a charge for such land is included in the total selling price of the real property sold.)

(A) Except as provided in subsection (b)(2) (B) below, the taxpayer must document such “fair market value” to the satisfaction of the Tax Collector, and maintain and provide such documentation upon demand in addition to and in like manner to the books and records required in Article III.

(B) In lieu of the documented fair market value of land allowed in subsection (b)(2)(A) above, an amount equal to twenty percent (20%) of the total selling price may be used to estimate the “fair market value” of land.)

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Very few cities have adopted these local options.

3. *Exemption Certificates.*

The Model Code exempts subcontractors from the tax imposed on construction contractors, only if the subcontractor has obtained a written declaration in one of the following situations:

a. Where a construction contractor has provided the subcontractor with a written declaration that the construction contractor is liable for the tax on the project and the construction contractor has provided the subcontractor both its Arizona transaction privilege license number and its city privilege license number;

b. Where an owner-builder has provided the subcontractor with a written declaration that the owner-builder is improving the property for sale; the owner-builder is liable for the tax for such construction contracting activity; and the owner-builder has provided the subcontractor its city privilege license number; or

c. Where the subcontractor is performing work for a construction contractor who has received a written subcontractor declaration in either of the two situations above.

Planning Tip: Contractors or specialty contractors who are contracting with either a prime contractor or an owner-builder/speculative builder should obtain the written

declaration from the prime contractor or owner-builder/speculative builder before performing any subcontracting services. If the subcontractor does not have such a written declaration, the city will treat that entity as a taxable construction contractor. Most cities have not issued forms for such written declarations and taxpayers need to prepare their own forms based upon the Model City Tax Code language (see above). It is unclear whether the cities would accept the state "Prime Contractor's Exemption Certificate," Form 5005. The City of Scottsdale has issued forms which are included with these materials.