This Tax Facts is designed to explain how sales and use tax applies to spec builders and property built to lease. If this Tax Facts does not answer your specific question, please call the Department's toll-free Helpline at 1-800-829-9188 between 8:00 AM – 5:00 PM CST, Monday through Friday.

Information found in this document rescinds and replaces all previously written information on this subject. All readers and users of this publication are responsible for keeping informed about changes in tax laws and regulations by reading the department’s newsletters, press releases, Tax Facts, and other documents published by the Department of Revenue.

Terms Used

Fair Market Value of Land
The following items may be considered in determining the fair market value of the land:
1. IRS Cost basis
2. Appraisal value
3. Property tax value – marked up to 100%

Fair Market Value of Building
The fair market value is the cash price a property would bring in a competitive and open market.
The following items may be considered in determining a fair market value:
1. Insurance value
2. Appraisal value
3. Property tax value – if valued at less than 100% need to increase the value to 100%
4. Cost – all costs involved in the building including labor, materials and contractors’ excise tax.

Spec Builders
Any person that makes a realty improvement and sells the property containing the realty improvement within four years of its completion is subject to contractors’ excise tax. This person is referred to as a spec builder. Realtors, investors, individuals, and contractors are examples of people that may be spec builders.

A spec builder is an individual who holds title to the land and builds with the intent to sell. A spec builder may be building a new building or purchasing and remodeling an existing structure to be sold.

Any person, who buys and sells investment property, where a house is purchased, fixed up and then put back on the market has the same tax liability as a contractor who builds new buildings. This is also known as “flipping.”

Criteria to be a Spec Builder:
1. Must own the realty improvement project.
2. Is building with the intent to sell; they are not hired by someone else for this project.
3. Is building a new building or remodeling an existing structure.
4. May do all, some or none of the construction or they may hire others to do part or all of the construction.

Tax Responsibilities of a Spec Builder:
1. Is required to have a contractors’ excise tax license.
2. Must issue Prime Contractor Exemption Certificates to sub contractors that are building the structure.
3. Can not issue Prime Contractor Exemption Certificates for land improvements.
4. Is responsible for the contractors’ excise tax when the realty improvement is sold, if it is sold within four years of completion.

Contractors’ Excise Tax
The spec builder will owe 2% contractors’ excise tax when the realty improvement is sold. The contractors’ excise tax is reported in the same reporting period as the closing. Contractors’ excise tax does not apply if the realty improvement is sold more than four years after the date of completion.

The 2% contractors’ excise tax applies to the selling price of the realty improvement. The spec builder may deduct the cost or fair market value, whichever is greater, of any land and land improvements included in the sale if contractors’ excise tax was paid on the land improvements. Land improvements include water, sewer, power, curb and gutter, and sidewalks.

A spec builder that is flipping property (buying existing structures that are remodeled and sold) may deduct the amount they paid for the property.

Examples
1. Tad’s Development buys a lot in July 2012 for $20,000 and builds a spec home. Tad’s Development hires Sue’s Concrete to install the curb, gutter, and sidewalk for $5,000, which includes the contractors’ excise tax. Tad’s Development sells the spec home for $250,000 in February 2013. On their February 2013 return, Tad’s Development owes 2% contractors’ excise tax on $225,000. ($250,000 selling price less the land cost of $20,000 less the $5,000 paid for land improvements that included contractors’ excise tax.)
2. Sue’s Concrete buys a lot in 2012 for $20,000 and builds a spec home. Sue’s Concrete does the curb and gutter, sidewalk
and driveways. The spec home is sold in 2013 for $250,000. Sue’s Concrete owes contractors’ excise tax on the $230,000 ($250,000 less the land cost of $20,000). Only the cost of the land may be deducted as no contractors’ excise tax was paid on the concrete work done by Sue’s Concrete.

3. Sam’s Construction bought land in 2011 for $50,000 and divided the land into 5 lots. In 2011, electricity, water and sewer were added at a cost of $100,000, including contractors’ excise tax, to each lot. Sam built a spec home on one lot in 2011 that sold in January 2013 for $200,000. In December of 2011, the remaining lots sold for $30,000 each. On his January 2013 return, Sam will owe contractors’ excise tax on $170,000 from the sale of the spec home. ($200,000 less the fair market value of the lot $30,000.) No tax is due on the sale of the lots.

4. Dudley Realtor buys a lot for $20,000. Dudley Realtor hires ABC Construction for $125,000 to build a home that Dudley Realtor intends to sell. Dudley Realtor sells the home for $200,000 within two weeks of the construction being complete. Dudley Realtor is a spec builder and must have a contractors’ excise tax license. Dudley Realtor must issue ABC a prime contractors’ exemption certificate. Dudley Realtor owes 2% contractors’ excise tax on $180,000. (The $200,000 less the land cost of $20,000.)

5. John Doe buys an old house for $80,000 with the intent of remodeling and selling (flipping) the property. He hires Do-It-Right Construction for $50,000 to completely remodel the house. The house is sold for $160,000 a month after the remodel is complete. John Doe is a spec builder and must have a contractors’ excise tax license. He must issue Do-It-Right a prime contractors’ exemption certificate. John will owe 2% contractors excise tax on $80,000 ($160,000 selling price less $80,000 cost of the original structure).

Joint Ventures
When two or more parties undertake a project together they are required to have a tax license as a new entity. This is required even if each of the parties have their own tax license. These parties are creating a new entity by both contributing equity, and then sharing in the revenues, expenses, and control of the project.

Example:
1. Ivan, an investor, and John, a contractor, each contribute $100,000 to purchase land and build a home. When the home is sold they will split the profits. Ivan and John have formed a new entity and are required to have a contractors’ excise tax license showing both as owners. When the home sells the contractors’ excise tax is paid under the new license.

Rental or Use of a Spec Home
A contractor that decides to move into a spec home will owe contractors’ excise tax during the reporting period when the home is first used. The 2% contractors’ excise tax is due on the amounts paid to subcontractors that were issued prime contractor exemption certificates.

A contractor that decides to rent a spec home to another person and the rented home has a fair market value greater than $100,000, the contractor will owe 2% contractors’ excise tax on the fair market value of the home (this does not include the land value). If the rented home has a fair market value less than $100,000, then the contractor owes the 2% contractors’ excise tax on the amounts paid to subcontractors that were issued prime contractor exemption certificates. See Buildings Built for Lease-$100,000 Rule for additional information.

When the home is sold within four years of completion the 2% contractors’ excise tax is due on the selling price, less the cost or fair market value of the land and less the amount excise tax was paid on when the home was occupied by the owner or renter.

Examples:
1. CC Contracting rents a spec home that is valued at $150,000. (The $150,000 does not include the land value.) When this home is rented CC owes 2% contractors’ excise tax on the $150,000.

The spec home is sold a year later for $200,000. At the time of sale, CC will owe 2% contractors’ excise tax on $25,000. (The selling price $200,000 less $150,000, the amount excise tax was previously paid on, less $25,000 cost of land.)

2. CC Contracting has a second spec home valued at $230,000 that has been on the market for eight months. Subcontractors were issued prime contractor exemption certificates and were paid a total of $130,000. CC paid $25,000.00 per lot.

• CC decides to live in this home rather than leave it vacant. 2% contractors’ excise tax is due on the $130,000 paid to the subcontractors’ on this home.

• CC sells the home a year later for $250,000. CC will owe 2% contractors’ excise tax on $95,000. ($250,000 less $130,000 tax was already paid on, less $25,000 cost of land.)

Homes Built for Own Use
Any person, including any licensed contractor, that builds a home that is intended as their personal residence is not a prime contractor on that project. A contractor cannot issue prime contractor exemption certificates when building a home or other structure for his use. All contractors hired are responsible for reporting the 2% contractors’ excise tax on their receipts.

If a home built by a licensed contractor for their own use is sold within four years of completion, the licensed contractor will owe excise tax on the selling price, but will be allowed to deduct the contractors’ excise tax that was previously paid.
Speculative Builders, $100,000 Rule

Example:
CC Contracting buys a lot for $25,000 and hires two contractors to help him build a home for his use. CC pays the contractors $50,000, which includes contractors’ excise tax. Two years later CC sells this home for $250,000. At the time of closing CC will owe 2% contractors’ excise tax on $175,000. ($250,000 less $25,000 for land cost and $50,000 paid to contractors that included the contractors’ excise tax.)

Buildings Built for Lease - $100,000 Rule
When a building is to be leased to others and the fair market value of a new building is greater than $100,000 the owner is a prime contractor and subject to contractors’ excise tax if:

1. The owner has a contractors’ excise tax license; or
2. If the owner is not a licensed contractor, they perform part of the construction.

As a prime contractor, the owner is responsible for the 2% contractors’ excise tax on the fair market value of the building. The contractors’ excise tax is reported in the same reporting period the improvement is leased.

If the owner is not a licensed contractor and the owner and his employees do none of the construction, then the owner is not a prime contractor and is not subject to the contractors’ excise tax.

When the owner is not the prime contractor, each contractor hired by the owner is a prime contractor and is responsible for the 2% contractors’ excise tax on their receipts. The 2% contractors’ excise tax also applies to the materials furnished by the owner. The cost or fair market value of the owner furnished materials includes sales or use tax on the material.

If the realty improvement sells within four years after completion, 2% contractors’ excise tax is due on the selling price, less the land and land improvements. If contractors’ excise tax was previously paid on this building, a credit will be given towards the contractors’ excise tax due on the selling price.

Examples:
1. A contractor builds an apartment building with a fair market value of $1,000,000. Land cost of $100,000. In August 2011, he begins renting the apartments. The contractor is liable for 2% contractors’ excise tax of $20,000 on the fair market value of the building on the August 2011 monthly return ($1,000,000 x 2%).

2. The same apartment building sold November 15, 2012. 2% contractors’ excise tax is due on the selling price of $1,500,000, less $100,000, the land cost and $1,000,000, the amount contractors’ excise tax was previously paid on. $1,500,000 - $100,000 - $1,000,000 = $400,000. $400,000 x 2% = $8,000 tax due.

3. Jim Jacobs is a dentist and does not have contractors’ excise tax license. Jim hires CC Contracting to build a $1,250,000 apartment building. Jim does no work on this complex. CC Contracting is the prime contractor. CC Contracting owes the 2% contractors’ excise tax on their receipts. Jim does not owe contractors’ excise tax when the building is leased and cannot issue prime contractor exemption certificates.

Construction Managers
Construction manager services are subject to sales tax. Construction managers supervise or oversee construction projects. They do not provide any of the construction work. A construction manager may oversee the hiring of contractors; however, the contractors enter into contracts with the owner and are paid directly from the owner’s account.

A construction manager that does some or all of the construction, hires contractors, or pays the contractors from the manager’s funds is a prime contractor and is subject to the contractors’ excise tax.

Prime Contractor Exemption Certificates
As a prime contractor, a spec builder must give prime contractor exemption certificates to all contractors providing realty improvements on their project. Spec Builders should not give prime contractor exemption certificates for the land improvements.

The prime contractors’ exemption certificate must show the spec builder’s name, address, and contractors’ excise tax license number, the project location, and the subcontractors’ name, address, and contractors’ excise tax license number.

Subcontractors must retain the prime contractors’ exemption certificates in their records. Any subcontractor who fails to retain a prime contractors’ exemption certificate for each project is considered a prime contractor and is subject to the 2% contractors’ excise tax.

Subcontractors
A “subcontractor” is a person contracting to perform all or part of a realty improvement for a prime contractor. A subcontractor’s gross receipts are not subject to the 2% contractors’ excise tax provided they have a completed prime contractor’s exemption certificate from the prime contractor for each project, unless the work is for a qualifying utility.

State Sales and Use Tax
Spec builders and all contractors must pay the 4.5% state sales or use tax, plus applicable municipal tax, on all material and sales taxable services they purchase for a spec home or property they are remodeling and selling.

The contractors’ excise and use taxes are part of the contractor’s total bill and are collectible from all entities, both public and private.

Additional municipal use tax may be due when the material is used. If the contractor paid 4.5% state sales or use tax on the material where the material was delivered, the contractor owes the municipal use tax if the material is used inside the municipality that imposes a city tax. The city use tax is due on the cost of the material, including delivery charges.

Supplies, materials, or services purchased are subject to use tax, if no sales tax was paid at the time of purchase. The 4.5% state and applicable municipal use tax is payable to the Department of Revenue in the reporting period in which the contractor is
Speculative Builders, $100,000 Rule

Talk to Us!

If you have a tax problem or question, call the South Dakota Department of Revenue toll-free at 1-800-829-9188. Visit us on the web at http://dor.sd.gov email us at bustax@state.sd.us or write us:

South Dakota
Department of Revenue
445 East Capitol Ave.
Pierre, SD  57501

Aberdeen
14 South Main, Suite 1-C
Aberdeen, SD  57401

Mitchell
417 N. Main, Suite 112
Mitchell, SD  57301

Rapid City
1520 Haines Avenue, Suite 3
Rapid City, SD  57701

Sioux Falls
300 S. Sycamore, Suite 102
Sioux Falls, SD  57110

Watertown
715 S Maple
Watertown, SD  57201

Yankton
1900 Summit Street
Yankton, SD  57078

invoiced. Use tax is also due on supplies taken out of retail inventory for the business’ use in the reporting period they are taken out of inventory.

Tangible personal property delivered into South Dakota by the supplier is subject to the South Dakota sales or use tax, even if the supplier charges another state’s sales tax.

When a purchase is made out of state and possession is taken out of state the supplier may charge that state’s sales tax. If the rate of the other state’s sales tax is the same or more than South Dakota’s tax rate, no South Dakota use tax is due. If it is less than South Dakota’s, the difference is subject to use tax. Add the state and any applicable city rates together to determine if additional use tax is due.

Examples of services subject to sales or use tax:
engineering, accounting, computer services, business consulting, surveying or staking, architectural planning, testing, rock crushing, laying carpet, vinyl or wood flooring, and landscaping (laying sod and planting trees and flowers).

Municipal Sales and Use Tax
Many municipalities in South Dakota impose a sales and use tax in addition to the 4.5% state sales and use tax. If the customer receives a product or service in one of these municipalities, the product or service is subject to that municipality’s sales tax. A municipality’s general tax rate is listed under the column heading “Rate” in the Municipal Tax Information Bulletin which is available on our web-site at http://dor.sd.gov or by calling 1-800-829-9188.

Required Records
Records, such as contracts, prime contractors’ exemption certificates, purchase and sales invoices, bills of lading, books of all receipts and sales, cash register receipts, job cost detail, and other pertinent papers and documents, are required to be kept for at least three years and be available for inspection during business hours.