Sales and Use Tax on Road Construction

Sales & Use Tax on WSDOT Projects on State-Owned Highways
Washington State sales and use taxes are generally applied to construction contracts. As such, contractors working on WSDOT projects on state-owned highways are taxed in two ways:

1) Contractor purchased materials consumed during construction. When WSDOT contractors purchase materials that will be utilized or consumed by the contractor during construction (i.e. temporary striping, barricades), the contractor is charged sales tax at the point of purchase. This contrasts with materials like asphalt that become part of the final product; for these, the contractor does not pay sales tax at the time of purchase.

2) Contractor gross receipts. Sales and use tax is applied to the contractor’s total billing, including charges for labor, services, sub-contractor costs, and materials, including both consumed materials and materials that become part of the final product. Because the consumed materials are normally part of the overall billing, this means that sales tax is applied a second time to such materials.

Public Road Construction Exemption: local jurisdictions and federal government
Road construction paid for by local jurisdictions and the federal government are partially exempt from sales and use taxes. 

RCW 82.04.050(10) exempts construction labor and services from sales and use tax when construction occurs on highways owned by cities, counties, special districts or the federal government. When first adopted in 1943, the exemption applied to construction on highways owned by the state. In 1971, the RCW was amended to remove construction on highways owned by the state from the exemption.

Under the Public Road Construction Exemption, sales and use tax is not paid on the full contract price. It is paid by contractors on all materials (and services associated with the provision of those materials) purchased or used for the work whether they are installed as part of the construction or consumed during construction.

The Washington Department of Revenue 2016 Tax Exemption Study identifies the purpose of the exemption as: 1) taxing contractors who do work for the federal government on the value of the materials they incorporate into the project; and 2) reducing costs for local jurisdictions. The study’s estimated savings to taxpayers from the exemption in the 2015-17 biennium is $250 million in state tax and $95.0 million in local taxes.

Taxation of federal projects
Under the Supremacy Clause of the United States Constitution, the state cannot directly tax the federal government. On construction projects, the state only imposes sales and use tax on materials purchased by federal contractors.

The United States Supreme Court, in a 5-4 decision, upheld Washington’s taxation of federal contractors in Washington v. United States, 460 U.S. 536 (1983). The important question, according to the Supreme Court, is whether the tax is discriminatory with regard to the economic
burdens that result. “The important consideration is not whether the State differentiates in
determining what entity shall bear the legal incidence of the tax, but whether the tax is
discriminatory with regard to the economic burdens that result. The State does not discriminate
against the Federal Government and those with whom it deals unless it treats someone else better
than it treats them. Here, Washington has not singled out contractors who work for the United
States for discriminatory treatment. It has merely accommodated for the fact that it may not
impose a tax directly on the United States as the project owner.”

The Department of Revenue has expressed concern that creating new exemptions and deferrals
for construction projects present “a significant legal risk that the federal government or federal
contractors will seek to re-litigate Washington v. United States. Sales/use tax exemptions pose the
greatest legal risk because they plainly treat the beneficiaries of the exemption more favorably
than federal contractors are treated. Sales/use tax deferrals also pose a significant legal risk.”

Sales Tax Deferrals
Sales and use tax deferrals have been specifically granted by legislation for two tolled facilities:

- **SR 520.** [RCW 47.01.412](https://apps.leg.wa.gov/rcw/default.aspx?cite=47.01.412) defers state and local sales and use taxes on the SR 520
  improvements until the fifth year after the date certified by the Department of Revenue as
  the date on which the project is operationally complete. The project is operationally
  complete under this RCW when the replacement bridge is constructed and opened to
  traffic. Interest is not charged on the deferred sales and use taxes. Total estimated
  deferred state and local sales and use taxes are $159 million.

- **Tacoma Narrows Bridge SR 16.** [RCW 47.46.060](https://apps.leg.wa.gov/rcw/default.aspx?cite=47.46.060), as amended in 2015, defers state and
  local sales and use taxes on the Tacoma Narrows Bridge SR 16 corridor improvements
  until 2032. (Prior to the amendment, state and local sales and use tax were to be repaid
  2019.) The deferred tax, which totals $57.6 million, is to be repaid over 10 years. No
  interest is charged.

Connecting Washington
Chapter 44, Laws of 2015, 3rd Special Session authorized fund transfers from the General Fund—State
to the Connecting Washington Account for six biennia ending in 2031 ([RCW 82.32.385](https://apps.leg.wa.gov/rcw/default.aspx?cite=82.32.385)). The amounts
to be transferred represent refunds of sales taxes paid on the state highway projects authorized by the
Connecting Washington transportation revenue package.

**Source:** Joint Transportation Committee, “Efficiencies in the Construction and Operation of State