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. 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 2017-19 biennium is $256 million in state tax and $97 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 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 $159.4 million.

- **Tacoma Narrows Bridge SR 16**. RCW 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. The statute include a provision that permits the Department of Revenue to authorize an accelerated repayment schedule upon the request of the Department of Transportation. 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). The $518 million required to be transferred represents 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 Transportation Projects, Appendix A.” January 13, 2014.