



WASHINGTON STATE SALES TAX ON RECLAMATION PROJECT IRRIGATION DISTRICTS



INTER- GOVERNMENTAL TAX IMMUNITY



INTERGOVERNMENTAL TAX IMMUNITY

US Constitution Article VI, Clause 2 –
Supremacy Clause:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, **shall be the supreme Law of the Land**; and the Judges in every State shall be bound thereby; **any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.**



INTERGOVERNMENTAL TAX IMMUNITY

- Intergovernmental tax immunity is a legal principle that ensures the sovereignty of the federal and state governments. This principle represents a constitutional check on the powers of both the federal and state governments to levy taxes on each other.
- First established by the US Supreme Court in *McCulloch v. Maryland* (1819)
 - State taxation of the federal government is interference with the federal government's exercise of its constitutional powers



INTERGOVERNMENTAL TAX IMMUNITY

- Tax Immunity can apply on an agency or instrumentality "so closely connected to the [federal] Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *US v. New Mexico* (1982)
 - A finding of constitutional tax immunity requires something more than the invocation of traditional agency notions.
 - There is no bright line rule to determine whether an entity is an instrumentality exempt from state taxation. *Metcalf & Eddy v. Mitchell* (1926)



FEDERAL INSTRUMENTALITIES

- Intergovernmental Tax Immunity does NOT extend to contractors of the federal government
- The Federal Government's constitutional immunity from state taxation may not be conferred on a third party simply because the tax has an effect on the United States, or even because the Federal Government shoulders the entire economic burden of the levy. Nor can immunity be conferred simply because the state tax falls on the earnings of a contractor providing services to the Government. *US v. New Mexico* (1982)
 - First established in *James v. Dravo Contracting Co.* (1937)



FEDERAL INSTRUMENTALITIES

- Instrumentality Determinations:
 - *New York ex rel Rogers v. Graves* (1937): Panama Railroad Company is an instrumentality
 - *Department of Employment v. US* (1966): Red Cross is an instrumentality
 - *Standard Oil v. Johnson* (1942): post exchanges are an instrumentality
 - *Clallam County v. US* (1923): state corporation created to build airplanes for war effort was an instrumentality
- Contrast the majority of cases finding that an entity was not a federal instrumentality do so because that entity is a private for-profit corporation that is receiving private gain from its dealings with the federal government.



FEDERAL INSTRUMENTALITIES

- RCW 87.03.010(5): An irrigation district may be organized or maintained for any or all the following purposes: the execution and performance of any contract authorized by law with any department of the federal government or of the state of Washington, for reclamation and irrigation purposes.
- Repayment Contract Clauses:
 - Transfer of care, operation, and maintenance of facilities not title
 - Requirement of approval by USBR of any major changes to facilities
 - Default provisions allowing US to take over care, operation, and maintenance
 - Collection agent of the United States for repayment



WASHINGTON
STATE:
GOVERNMENT
CONTRACTING
TAXATION



WASHINGTON V. US (1983)

- Before 1941, building contractors were treated as consumers for sales tax purposes. All sales of tangible personal property, such as construction materials, to contractors were subject to the sales tax. The legal incidence of this tax was on the contractor; the tax was collected by suppliers who sold to contractors, and remitted by them to the state.



WASHINGTON V. US (1983)

- In 1941, Washington changed the sales tax system it applied to contractors by defining the landowner who purchases construction work from the contractor, rather than the contractor, as the “consumer.” The legal incidence of the tax was now on the landowner, who paid tax on the full price of the construction project. The net result was that contractors' labor costs and markups were added to the tax base, which had previously included only the cost of tangible personal property sold to contractors.



WASHINGTON V. US (1983)

- The post-1941 tax system could not, however, be applied to construction for the Federal Government because the Supremacy Clause prohibits states from taxing the United States directly. Thus, when the United States was the landowner, Washington did not collect any tax on the sale either of tangible personal property to the contractor or of the finished building to the Government.



WASHINGTON V. US (1983)

- In 1975, the Washington Legislature acted to eliminate the complete tax exemption for construction purchased by the United States. It did so by re-imposing the pre-1941 tax on contractors that work for the federal government ("federal contractors"). Thus, Washington now taxes the sale of non-federal projects to the landowner, and taxes the sale of materials to federal contractors. The net result is that for federal projects the legal incidence of the tax falls on the contractor rather than the landowner, and the tax is measured by a lesser amount than the tax on non-federal projects because the contractor's labor costs and markup are not included in the tax base.



WASHINGTON V. US (1983)

- In 1983, the Supreme Court of the United States upheld the government contracting taxation treatment against a challenge that because it treated federal contractors differently than other contractors it was discriminatory.
- SCOTUS held that because the taxation scheme did not result in greater economic burdens on federal contractors (less tax not more is paid under government contracting taxation) it was not discriminatory.



RCW 82.04.050(12)

- “[‘Retail Sale’] does not include the sale of or charge made for **labor and services** rendered in respect to the **constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for the US, any instrumentality thereof**,..., including the installing, or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation. Nor does the term include the sale of services or charges made for the clearing of land and the moving of earth of or for the US, any instrumentality thereof,...”



RCW 82.04.190(6)

- Consumer means the following: “Any person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the US, any instrumentality thereof...Any such person is a consumer within the meaning of this subsection in respect to tangible personal property incorporated into, installed in, or attached to such building or other structure by such person,...”



WAC 458-20-17001(2) – B&O TAX

- (a) Manufacturing. Government contractors that manufacture or produce any tangible personal property for their own commercial or industrial use in performing government contracting activities must report the value of the property manufactured under the manufacturing B&O tax classification. See RCW 82.04.240. In these circumstances, the government contractor is considered the consumer of the manufactured product and should not report the value of the manufactured product on either the retailing or wholesaling B&O tax classifications. The multiple activities tax credit is not allowed on this transaction.



WAC 458-20-17001(2) – B&O TAX

- (b) Government contracting. Persons, including subcontractors, engaged in constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property, including installing or attaching tangible personal property therein or thereto, and clearing land or moving earth, of or for the United States, its instrumentalities, or county or city housing authorities of chapter 35.82 RCW are taxable under the government contracting B&O tax classification, on the gross income from those activities. See RCW 82.04.280 (1)(g). The measure of the tax is the gross contract price.



WAC 458-20-17001(3) – SALES TAX

- (a) Government contracting activities excluded. The retail sales tax does not apply to any portion of the contract price for any business activities taxable under the government contracting B&O tax classification described in subsection (2)(b) of this section.



WAC 458-20-17001(3) – SALES TAX

- (b) Materials. Prime and subcontractors engaged in government contracting are "consumers" under RCW 82.04.190 and must pay retail sales tax or use tax on all purchases of materials. Examples of common materials on which sales or use tax would apply include prefabricated and precast items, equipment, and other tangible personal property installed, applied, attached, or otherwise incorporated in their government contracting work.



WAC 458-20-17001(3) – SALES TAX

- (c) Tools and consumables. Government contractors must pay retail sales tax on purchases and leases or rentals of tools, consumables, and other tangible personal property they use as consumers in performing government contracting as described in subsection (2)(b) of this section.



WAC 458-20-17001(4) – USE TAX

- (a) Use tax applies to the value of all materials, equipment, and other tangible personal property a government contractor purchases at retail, acquires as a bailee or donee, or manufactures or produces for commercial use or industrial use and upon which the contractor, its bailor, or its donor paid no retail sales tax.
- (b) Government contractors are required to remit use tax on the value of government-provided tooling as well as property provided by the federal government to the contractor for installation or inclusion in the contract work.
- (c) Either the prime contractor or a subcontractor may be held responsible for payment of the applicable use tax



TAX SAVINGS: EXAMPLE

As an example, on a \$1M construction contract subject to regular taxation, the state would receive the following tax revenue:

- Retail sales tax = \$79,000.00
- Business and occupation tax = \$4,710.00
- Total tax revenues = \$83,710.00
- Total contract price = \$1,083,710.00

Using the same \$1M construction contract but subject to government contracting classification:

- Retail sales tax on materials (\$500k) = \$39,500.00
- Business and occupation tax = \$4,840.00
- Total tax revenues = \$44,340.00
- Total contract price = \$1,044,340.00

Contract Savings = \$39,370



DOR RULINGS

- Sunnyside Valley Irrigation District (2010)
- Quincy-Columbia Basin Irrigation District (2009 & 2012)
- East Columbia Basin Irrigation District (2005 & 2010)
- Lake Chelan Reclamation District (2022)



PUBLIC WORKS CONTRACT LANGUAGE

SALES TAX

Sales Tax

The project is located in _____ County, WA. Taxes shall be paid for the appropriate amount of work performed in the county. Taxes shall be based on current rates for _____ County, WA.

Pursuant to RCW 82.04.050, the District is exempt from paying State of Washington sales and use tax on equipment and labor portions of the Project cost. In the “Estimated Sales Tax on Materials” item in the Bid Schedules, Bidders shall include the combined Washington State and _____ County estimated Sales and Use Taxes that the Contractor will pay on purchases of materials and supplies used or consumed in the Project. Based on receipts submitted, the District will reimburse the Contractor for the actual amount of Sales and Use Taxes paid on purchases of materials and supplies used or consumed in the Project.

Except as indicated above, all other taxes required by federal, state, or local laws shall be included in the appropriate bid item unit price, or lump sum price, in the Bid Schedules.



SALES TAX ON EQUIPMENT & MATERIALS



LAKE CHELAN RECLAMATION DISTRICT RULING

- [LCRD] is not required to pay retail sales tax when it purchases supplies and equipment for the operation and maintenance of the irrigation system. It is our understanding that for the purposes of their irrigation district, the LCRD is considered to be part of the federal government (US Bureau of Reclamation). Therefore, any supplies or equipment purchased for the operation and maintenance of the irrigation system is exempt from retail sales tax.



LAKE CHELAN RECLAMATION DISTRICT RULING

- If the primary use of the item will be for the irrigation district, then LCRD may purchase the item exempt from sales tax. However, LCRD owes use tax on the current market value upon first use by one of their other lines of business.
- If the primary use of the item will be for one of the other lines of business, then LCRD should pay sales tax at the time of purchase.



LCRD SALES TAX REFUND

- LCRD has submitted the Application for Refund or Credit to the Department of Revenue
 - DOR is requiring verification of sales tax paid
- RCW 82.32.060: Refund of excess payment of tax
- RCW 82.32.050: 4 Years after Close of Tax Year



WAC 458-20-190

- Sales to and by the United States and Instrumentalities
- Obligation of documenting tax exempt sales is on sellers
- Department of Revenue does not provide a certificate or other document stating exemption from tax for federal instrumentalities



QUESTIONS?

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