



## **BRIEFLY**

The construction of a new home generates a considerable amount of revenue for state and local government. About half of this is sales tax. And about half of all of the tax and fee revenue goes to the state rather than to local governments.

# Taxes and Fees on the Construction of a House

The construction of a new home generates a considerable amount of revenue for state and local government.

This brief details the taxes and fees that government receives as a result of the construction of a house. The analysis is based on an actual house recently constructed in Kirkland. This house sold for \$250,000, well below the average price for new houses in King County. Even so the construction and sale of such a house generates nearly \$22,000 in taxes and fees for state and local government.

## **Sales Tax**

Generally, it is the sales tax that accounts for the largest share of government revenue from the construction of a house.

The calculation of the amount of sales tax generated by the house is somewhat complicated. The sale by a builder of a completed house to a consumer is not subject to the sales tax, for in Washington state the sale of real estate is exempt from the retail sales tax. However, the builder's purchases of construction materials and payments to contractors for construction work are subject to the tax.

In King County, the sales tax rate is 8.8 cents per dollar. Of this, 6.5 cents goes to the state. If the sale takes place in unincorporated King County, the county gets 1 cent for general purposes. If, instead, the sale takes place in a city, the city gets 0.85 cent and the county gets 0.15 cent. The county also gets 0.8 cent for Metro transit, the county's bus system. (This rate recently increased from 0.6 cent.) Sound Transit, the regional transit system gets 0.4 percent. Finally, 0.1 cent goes into a County criminal justice fund, which distributes money to cities and the county based on population.

Sales taxes on the Kirkland house total \$10,391.

## **Real Estate Excise Tax**

The sale of real estate is subject to the Real Estate Excise Tax (REET). For sales in King County, the seller pays a state REET at the rate of 1.28 percent of the purchase price and a local REET at the rate of 0.50 percent. The local REET goes to the county if the property is located in an unincorporated area; otherwise it goes to the city.

REET is collected both when the builder buys the lot and when the builder sells the completed house to the consumer. In the case of the Kirkland house, REET totals \$4,865.

## **Business and Occupation Tax**

As a sale of real property, the sale by a builder of a completed home to a consumer is not subject to the state business and occupation (B&O) tax.



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However, payments received by a primary contractor are subject to the B&O tax at the retailing rate, 0.471 percent, while those received by subcontractors are taxed at the wholesaling rate, 0.484 percent. Similarly, sales of materials to a builder or a contractor are subject to B&O.

B&O tax on the Kirkland house totals \$555.

### Property Tax

The builder will pay property taxes over the period that he owns the lot. A number of different jurisdictions receive shares of the property tax, including the state, county, city, and school district. For the Kirkland house, the builder owned the lot for 18 months and paid \$430 in property taxes.

The owner of the new home will pay about \$2,700 annually in property tax.

### Impact Fees

State law provides local governments with a number of tools through which to recoup from developers and builders the costs of providing public facilities to serve new housing. Foremost among these tools are impact fees.

The growth management act allows local governments to assess four types of impact fees: for fire protection, parks, schools, and roads. The money raised through impact fees must be spent “for system improvements that are reasonably related to the new development,” and only “in conformance with the capital facilities plan element of the comprehensive plan.”

<b>Taxes and Fees on a New \$250,000 House</b>	
Sales Tax	10,391
Business & Occupation Tax	555
Property Tax	430
Real Estate Excise Tax	4,865
School impact fees	0
Transportation impact fees	966
Parks impact fees	612
Fire Protection impact fees	0
Water/Sewer connection charges	3,861
<b>Total</b>	<b>21,680</b>

The builder of the Kirkland house pays to the city a road impact fee of \$966 and a park impact fee of \$612.

However, because Kirkland is an established urban area the builder does not pay impact fees for fire protection or schools.

Fire protection is provided by the City of Kirkland. The city’s existing fire protection facilities are sufficient to handle the growth foreseen in the near term, and new developments do not require major

improvements to the city’s fire protection facilities. A 1998 survey conducted by the Association of Washington Cities found that fire protection impact fees are relatively rare, with the greatest fee being the \$313 imposed by Mount Vernon.

The situation is similar for schools. The Lake Washington School District serves Kirkland, Redmond, part of Sammamish, and portions of unincorporated King County. Overall, the district is adding new classrooms to serve growing enrollments. However, enrollments at the district’s Kirkland area schools are below capacity. For that reason, the City of Kirkland does not impose a school impact fee.

The district does receive a fee of \$4,279 for a single-family house built in unincorporated King County. And this amount is less than the \$6,131 that the County collects for the Issaquah School District.



## Connection Charges

In some cases a new residential unit imposes no cost on the city for water or sewer, as the existing capacities of water and sewer lines are sufficient to accommodate the increased flows. In other cases there is a need to increase capacity. New housing in Kirkland pays water and sewer capital facility charges that have been set to recoup these costs on average.

The water capital facilities charge for the house is \$2,150. The sewer charge is \$1,711.

### Distribution of Revenue from New \$250,000 Homes

State of Washington	11,844
King County	236
City of Kirkland	7,875
Lake Wash. School District	141
Metro Transit	945
Sound Transit	472
King County Criminal Justice	118
Other Districts	49
<b>Total:</b>	<b>21,680</b>

## The Bottom Line

In the Kirkland example state and local government would receive \$21,680 in taxes and fees as a direct result of the construction of the \$250,000 house. Taxes thus represent about 8.7 percent of the selling price. A little over one half of this amount, \$11,844, goes to the state. The city gets 36 percent, \$7,875. The county gets a total of \$1,181, for its general fund and for transit, 5 percent of the total. In this example, the school district receives only a small amount, because the local schools have the capacity to absorb the

additional enrollments generated by new housing and no school impact fee is imposed. In other locations, school districts receive considerable revenue from the construction of houses.

At the state level, nearly all of the revenues go into the general fund, to pay for ongoing state services. At the local level, 70 percent of the revenues are dedicated to fund the construction of public facilities, while 30 percent pay for general operations.

It should also be noted that, in addition to the taxes and fees detailed here, government regulations may add between 10 and 20 percent to the cost of a new house. (See Washington Research Council, *Impact of Government Regulations and Fees on Housing Costs*, ePB 01-18, May 24, 2001.)

## Does Growth Pay for Itself?

Many studies claim that most residential development doesn't pay its own way. As a general rule, they say, residential development costs more than the revenue it generates. The main drivers of this equation are the number of children (school costs), the level of service provided, and the value of the property. Those that say growth does not pay for itself point out that there is no service demand from the new residents until they move in to the home. After they move in, they demand services in excess of their property taxes. However, what these claims fail to take into account is other tax revenues these individuals provide through increased sales and business taxes.

Retail, commercial and industrial land uses generally provide positive net revenues to the local governments and often offset the "shortfall" associated with

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residential uses. And in fact, local governments sometimes seek to discourage residential construction while courting “profitable” nonresidential uses. While this adds to the economic vitality of the individual community, non residential land uses must be balanced with housing if regional economic development is to be sustainable. (see Washington Research Council *Managing Growth is a Balancing Act*, ePB 01-1 January 25, 2001, for a more detailed discussion).

As we have pointed out, building activity provides very attractive tax revenues to the state and local government. State and local governments may find it prudent (and a wise use of funds) to direct these one-time revenues to fund the gap in infrastructure needs. As the Washington Association of REALTORS points out, “Sufficient funding of infrastructure is a critical investment in our communities: it provides the backbone for a community’s quality of life, the framework for economic development, and lays the essential groundwork for accommodating residential, commercial, and industrial growth. Our state’s economic growth is threatened by the lack of sufficient infrastructure funding. We must provide a vision for achieving economic vitality and quality of life through a coordinated and prioritized Infrastructure Investment Strategy.”

If a community wants to get a handle on growth, it should facilitate quality growth through more effective use of its capital improvements program, and more effective use of the one-time tax revenues generated from home construction. Local governments should finance infrastructure projects that encourage economic growth and quality development. The construction of these community revitalization projects will encourage investments in job-producing private development, and expand the tax base. Community revitalization projects include infrastructure improvements — such as streets and roads, water and sewer systems construction, sidewalks and streetlights, parking and dock facilities, and park and recreation facilities. These investments will encourage the economic growth and prosperity the community wants and needs (see Washington research Council *Economic Growth and Prosperity*, ePB 00-35 December 4, 2000), bringing with it the increased on-going tax revenues from property, sales, and business taxes that will pay for the public services the community demands.





**What tax revenues does the construction of a house generate in your community?**

Use this work sheet to calculate the revenues generated by the construction of a house in your community. Because the calculation makes use of a number of rules of thumb, the result will be only an approximation.

Before performing this calculation, you will need to specify the value of the new house and determine a number of tax and fee rates:

- House value: (HV) = \_\_\_\_\_
- Local sales tax rate: (LST) = \_\_\_\_\_
- Local real estate excise tax rate: (LREET) = \_\_\_\_\_
- School impact fee: (SIF) = \_\_\_\_\_
- Transportation impact fee: (TIF) = \_\_\_\_\_
- Parks impact fee: (PIF) = \_\_\_\_\_
- Fire protection impact fee: (FPIF) = \_\_\_\_\_
- Water connection charge: (WCC) = \_\_\_\_\_
- Sewer connection charge: (SCC) = \_\_\_\_\_

The local sales tax rate can be calculated by subtracting the state rate of 6.5 percent from the overall tax rate in the jurisdiction where the house is being built. (In King County the overall tax rate is 8.8 percent and the local rate is 2.3 percent.)

The local real estate excise tax rate can be obtained from the county treasurer’s office, which is responsible for collecting the tax, or from a realtor. (The most common local rates are 0.25 percent and 0.50 percent.)

Impact fees and connection charges can be obtained from the local building department.

**Calculation**

	State		Local
Sales tax	0.0325 X (HV) = _____	(LST) X 0.5 X (HV) = _____	
B&O tax	.0024 X (HV) = _____		
REET	0.0128 X (HV) = _____	(LREET) X (HV) = _____	
Property tax	0.0005 X (HV) = _____	0.0015 X (HV) = _____	
School impact fee		(SIF) = _____	
Transportation impact fee		(TIF) = _____	
Parks impact fee		(PIF) = _____	
Fire protection impact fee		(FPIF) = _____	
Water connection charge		(WCC) = _____	
Sewer connection charge		(SCC) = _____	

Sum column for state total: \_\_\_\_\_ Sum column for local total: \_\_\_\_\_

Sum state and local totals for grand total: \_\_\_\_\_