May 3, 1939.

OPINION NO. 1704

TAXATION, GROSS INCOME; CONTRACTS' WITH UNITED STATES, TAXABILITY OF PROCEEDS FROM.

The gross income tax applies to gross receipts of private contractors from contracts with the United States for the construction of public works.

Honorable Wm. Borthwick,
Tax Commissioner,
Territory of Hawaii,
Honolulu, T. H.

Sir:

This is in reply to your letter of April 11 with reference to the application of Act 141, L. 1935 in connection with certain transactions with the United States government.

(1) Answering the first question in your letter as to whether the tax applies to gross receipts of local contractors from contracts with the United States for the construction of public improvements, this will confirm the oral opinion given Mr. Louis Silva at the time of the rendition of the decision of the United States Supreme Court in *James* v. *Dravo Contracting Co.,* 302 U. S. 134, 149, and more recently to Mr. Earl Fase.

The decision in that case involved the West Virginia law which, like our Act 141, L. 1935, imposes "annual privilege taxes" on account of "business and other activities". The Particular clause involved was similar to sec. 2-A (1) of Act 141, L. 1935, and read: "Upon every person engaging or continuing within this state in the business of contracting, the tax shall be equal to two per cent of the gross income of the business." The Tax Commissioner of West Virginia assessed the tax upon the gross amounts received from the United States under contracts entered into by the taxpayer with the United States for the construction of certain locks and dams, and this assessment was sustained: The decision notes that the contractor did not include in the estimated cost of the work or the contract price any specified item to cover the gross receipts tax and therefore it was not shown that the cost to the government was increased by the tax, but the court further held that even if the cost to the government were increased by

reason of the tax, that would not invalidate the tax. The case leaves open only one question in so far as the Federal Government is concerned, and that is, that it suggests Congress could intervene if the rate of tax were too high. In view of the fact that the case upheld a tax of 2% while our tax cannot exceed 1½%, this part of the decision need not concern us. The case was followed in *Silas Mason Co.* v. *Tax Commission,* 302 U. S. 186, involving the Washington Business and Occupation Tax.

Both the *Dravo* case and the *Mason* case also consider the question of jurisdiction over land owned by the United States, such as military reservations. This factor is mentioned in your letter, and is the second factor which must be considered. Unlike the first factor (the taxability of gross income derived from a contract with the United States) this factor is not settled by the above cited cases, since each reservation or other Federal property must be considered upon its own facts. While it undoubtedly is true that the Territory cannot tax the privilege of engaging in the business of contracting upon territory outside the legislative jurisdiction of the Territory of Hawaii, the authorities support the jurisdiction of the Territory of Hawaii over reservations and other Federal property within the exterior limits of the Territory. The authorities were reviewed in Op. Att'y Gen. (1937) No. 1660 and in a letter to the Governor dated *June 15, 1936,* as well as in other opinion letters since that date. Despite these authorities, which include the Supreme Court of the Territory, the Department Judge Advocate General has disputed the jurisdiction of the Territory over military reservations, and for this reason you may wish to consult the Governor before proceeding with assessments against contractors upon gross income from performance of work on military reservations.

(2) With regard to the second question in your letter, the answer is the same. There is nothing in the

Dravo case to indicate that a contractor is taxable only if he has other business in the Territory besides the Federal business, and the principles involved lead to the conclusion that the result is the same in case (2) as in case (1) above.

(3) The third question stated in your letter requires further consideration than I am able to give the matter at this time. Therefore, it will be the subject of an opinion at a later date.

Very truly yours,

RHODA V. LEWIS,
Deputy Attorney General.

APPROVED:

J. V. HODGSON,
Attorney General.