

SBKC:n
Op. No. 61-85

STATE OF HAWAII
Department of the Attorney General
Honolulu, Hawaii

August 22, 1961

Mr. J. A. Bell
Deputy Director of Taxation
State Of Hawaii
425 S. Queen Street
Honolulu, Hawaii

Dear Mr. Bell:

This is in response to your question concerning the treatment of "non-construction" costs of Capehart Project contractors under the general excise tax law (chapter 117 of the Revised Laws of Hawaii 1955 as amended) under the following circumstances:

Under the authority of Title IV of the Housing Amendments of 1955 (P.L. 345, 84th Congress; 69 Stat. 635), a military department of the United States issues an invitation for bids upon a particular project. In the total bid price is to be put construction costs, including overhead, profit, etc., plus any additional non-construction costs such as supervision, inspection and administration costs during construction and financing charges. On the basis of the lowest acceptable bid, a letter of acceptability is issued to the successful bidder called the "eligible builder." This eligible builder is then required to take four actions: first, to form a new corporation (called the "mortgagor-builder"); second, to arrange financing for the total cost of the project, including profit, by means of a building loan agreement between the mortgagor-builder and a mortgagee-lender; third, to cause the mortgagee-lender to obtain the Federal Housing Commissioner's commitment for insurance, and fourth, to execute a housing contract which defines the rights and obligations of the department, the eligible builder and the mortgagor-builder.

The primary functions of the mortgagor-builder corporation are: to lease from the government the land on which the project is to be built, to obtain funds for said project by mortgaging the leasehold interest, to pay the mortgage proceeds

Opinion No. 61-85

to the builder as the construction progresses up to the amount of the bid price, and to hold title to houses constructed. Immediately upon organization of the corporation, its stock along with the resignations of its officers and directors is irrevocably placed in escrow during the period of construction. As each housing unit is completed, it is placed under the control of the Secretary of Defense and when the entire project is completed the stock in escrow is delivered to him. The corporation itself thus remains in existence and continues to be the mortgagor. The mortgage loan, insured by FHA, is paid off with funds furnished by the Department of Defense and derived from quarters allowance of the military occupants of the housing. Apparently the mortgagor-builder corporation is not designed to make a profit on a project since any profit is to accrue only to the eligible builder who organized the corporation.

Under the above situation, it is the view of this office that all items entering into the total contract price, with the exception of pre-bid costs, constitute gross income subject to general excise taxation.

Section 117-3, Revised Laws of Hawaii 1955 as amended, defines "gross income" as meaning "the gross receipts of the taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property, or service, or both, and all receipts, actual or accrued as hereinafter provided, by reason of the investment of the capital of the business engaged in, including interest, discount, rentals, royalties, fees, or other emoluments however designated and without any deductions on account of the cost of property sold, the cost of materials used, labor costs, taxes, royalties, interest or discount paid or any other expenses whatsoever." see also section 117-2, Revised Laws of Hawaii 1955 as amended, which defines "business" as including "all activities (personal, professional or corporate) engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, but does not include casual sales."

"Non-construction" costs relating to the organization of the mortgagor-builder corporation as well as the other "non-construction" costs involved in the project enter into the gross income of the eligible builder because such costs are included under the contract obligations; that is, when the incorporators, insurers, FHA and others are paid, obligations of the eligible builder upon the contract (obligations

August 22, 1961

of which he is cognizant when making the bid for a project) are discharged. See Alabama v. King and Boozer, 314 U.S. 1, where it was held that the fact that government contractors were working under a cost-plus contract which entitled them to be reimbursed by the federal government for all materials purchased did not alter the fact that the contractors were the purchasers of the materials and the federal government had no direct liability for the purchase price. Where a taxpayer pays out money to meet his own liability and receives the money from another pursuant to an agreement by which he recoups this expense, in whole or in part, even though there is no direct object of gain or profit, such receipt is taxable gross income. North Pacific Coast Freight Bureau v. State, 122 P.2d 467; Peninsula Light Co. v. Tax Commission of Washington, 56 P.2d 720; Walgreen Co. v. Gross Income Tax Division, 75 N.E.2d 784. The same tax consequences follow even if the second party makes good the taxpayer's liability by direct payment to the third person involved. Vause & Striegel, Inc. v. McKibbin, 39 N.E.2d 1006; Merchants Cigar and Candy Co. v. City of Birmingham, 18 So.2d 137; Old Colony Trust Co. v. Commissioner, 279 U.S. 716.

However, with respect to "pre-bid" costs relating to two items, namely architect-engineer services and inspection fees, such amounts do not enter into the tax base since they are amounts incurred and disbursed by the military for services rendered to it even prior to the selection of an eligible builder. Thus the obligations met when these charges were paid, although included in the contract price, were the obligations of the military establishment initially contracting for such work.

In summary, under the contractual situation set out above, a Capehart contractor is subject to general excise taxes on the total contract price less "pre-bid" costs.

Very truly yours,

/s/ Samuel B. K. Chang

Samuel B. K. Chang
Deputy Attorney General

APPROVED:

/s/ Shiro Kashiwa

Shiro Kashiwa
Attorney General

Opinion No. 61-85