December 28, 1935.

OPINION NO. 1629

TAXATION, GENERALLY; MILITARY RESERVATIONS, JURISD1CTION OVER.

The Territory of Hawaii has jurisdiction to tax activities carried on within a

military reservation located in the Territory provided that the exercise of this taxing power does not interfere with the exercise of federal functions carried out through federal instrumentalities.

SAME; SAME.

The rule as to the jurisdiction of a territory over military reservations differs from the rule of the jurisdiction of a state over military reservations located within its borders.

POST EXCHANGES; NATURE AND STATUS.

A post exchange is a voluntary unincorporated, cooperative association of army organizations in which all share as partners in the profits and losses.

TAXATION, GENERALLY; POST EXCHANGES.

A post exchange, though organized and managed in accordance with Army Regulations, is not such a part of the Army as to come within that class of federal instrumentalities exempt from taxation by the Territory of Hawaii.

TAXATION, GROSS INCOME; EXEMPTIONS.

The General Excise Tax Law (Gross Income Tax), Act 141, L. 1935 exempts from taxation only those federal instrumentalities which are exempt by the Constitution of the United States.

SAME; SUBJECTS TAXABLE.

Post exchange are subject to the provisions of the General Excise Tax Law.

SAME; SAME.

Sales to post exchanges by a local merchant must be included in the measure

of the tax of a local merchant who is subject to the General Excise Tax Law.

SAME ; SAME.

Where goods are sold and delivered to an individual and the purchase price is billed to the post exchange, which collects from the individual, such method of collecting the purchase price does not make the transaction a sale to the post exchange.

Honorable William Borthwick,
Tax Commissioner,
Honolulu, T. H.

Sir:

You have requested of this department an opinion relative to the status of Army Post Exchanges under the General Excise Tax Law, (Gross Income Tax Act) Act 141, L. 1935. A determination of the status of this organization is necessary in order to answer the questions raised by the following hypothetical facts which you have submitted as being typical examples of many transactions involving Post Exchanges.

1. X, a merchant in Honolulu, sells merchandise to a soldier in the U. S. Army. Delivery is made over the counter, and the sale is charged to the soldier's personal account. Later X arranges with a Post Exchange at an Army post to collect this account from the soldier, the Post Exchange to receive 10 per cent of the account for making the collection. X claims that the original sale is exempt from the Gross Income Tax on the theory that (a) the sale is made to a federal instrumentality (the soldier) and (b) that collection is made through another instrumentality of the federal government (the Post Exchange).

2. X also sells merchandise to army personnel who reside in Honolulu. In such a transaction the purchaser

selects the merchandise which is delivered to his home in Honolulu. The bill, by pre-arrangement, is sent to the Post Exchange and thereby the purchaser obtains a 20 per cent discount. X claims that the sale is made to the Post Exchange or at any rate through the Post Exchange and is thereby entitled to exemption from the Gross Income Tax because made to or through a federal instrumentality.

3. X sells merchandise to a Post Exchange to be placed on the shelves of the organization and resold to persons eligible to purchase at the Post Exchange.

4. X sells to army organizations merchandise to be paid for out of Recreation Funds created by A. R. 210-50.

In the last two cases X claims that the sales are made to federal instrumentalities and are therefore exempt from the Gross Income Tax.

5. Certain persons operate concessions in conjunction with and under supervision of Post Exchanges. These concessionaires claim that they are federal instrumentalities and are not subject to the Gross income Tax.

6. The Post Exchanges make sales to certain persons on military reservations. The Post Exchanges claim that because they are federal instrumentalities they are not subject to the Gross Income Tax.

Although these several transactions involve different considerations which vary only in degree there is no doubt that if the Post Exchanges themselves, in example 6, are subject to the Gross Income Tax then all the other transactions will necessarily be subject to this tax. In order to simplify this opinion we shall consider only sales by Post Exchanges and sales to Post Exchanges.

In the following discussion we shall review the au-authorities under the headings:

I. Jurisdiction to Tax
II. Federal Instrumentalities
III. Specific Application of the Gross Income Tax Act.

I. *Jurisdiction of the Territory to Tax Property and Activities on Land Used by the Federal Government for Military and Naval Purposes.*

The first question which arises in our inquiry is, has the Territory of Hawaii jurisdiction to tax property located within or activities carried on within military or naval reservations. This question is not a new one and its answer is not entirely free from doubt. It has been presented to this Department on previous occasions, and will undoubtedly appear again in the future. The importance of the question merits a thorough review of the authorities so as to establish with as much certainty as is possible a sound basis for any conclusion we may reach. Before examining the court decisions we shall review briefly the earlier opinions of this Department.

A. *Opinions of Attorney General of Hawaii:*

Op. Att'y Gen. (1910) No. 184 answered in the negative the question: "Is a person employed by the United States government as a lighthouse keeper and residing wholly on a government reservation, exempt from the payment of the personal tax imposed under the laws of the Territory of Hawaii?" The reason given for the immunity of the lighthouse keeper from the poll tax was that the Territory had no jurisdiction over lands ceded to the United States for lighthouse sites because the Federal Government by the cession had *exclusive* jurisdiction over the area. The cases cited in support of this conclusion were decided by the Supreme Court of Massachusetts and involved land purchased by the United States from a *State* with the consent of the State Legislature and did not involve lands ceded by a terri-

tory. That this opinion reached an erroneous conclusion will be shown below in discussing the different rule applicable to territories.

Op. Att'y Gen. (1910) No. 187 held that the Territory had no jurisdiction to tax the personal property of an army officer which was on the military post at Schofield Barracks on tax day. This conclusion was based on a quotation from Cooley on Taxation which discussed the rule applicable to *States* where the land located in a *State* is purchased with consent of the State Legislature.

The erroneous basis of Opinion No. 187, *supra,* was pointed out in Op. Att'y Gen. (1915) No. 401, where it was said of the earlier opinion: "The opinion fails to distinguish between cases coming within the provision of the constitution conferring exclusive jurisdiction 'over all places purchased by the consent of the Legisture of the State in which the same shall be for the erection of forts, magazines, arsenals, dock yards, and other needful buildings', and the cases of military reservations not purchased or acquired with the consent of the State Legislature; in the former case, under the provision of the constitution, jurisdiction of the United States is absolute and exclusive, but in the latter, the jurisdiction of the United States Government is not exclusive except so far as it may be necessary for its use as a military post." The opinion concluded that Schofield Barracks fell within the latter class and that the Territory had jurisdiction to impose a tax on privately owned personal property of residents of military reservations situate within the Territory. This conclusion was supported by the Supreme Court of Hawaii in *Cassels* vs. *Wilder,* 23 Haw. 61, decided December 3, 1915 (discussed below).

Op. Att'y Gen. (1933) No. 1593 contains dicta to the effect that the Federal Government has not exclusive legislative jurisdiction over all lands of the United States in the Territory.

In Op. Let. Att'y Gen. (March 29, 1933), it was stated that the laws of the Territory relating to the soliciting of insurance were applicable to miliary reservations. The writer however, seemed to indicate that the case of *Territory* vs. *Carter*, 19 Haw. 198, on which he based his opinion affirming the jurisdiction of the Territory over such lands, was of somewhat shaky authority because of the growing tendency of the Federal courts to guard with jealousy the Federal domain.

In Op. Let. Att'y Gen. (July 11, 1933), the Attorney General concluded that the Hawaii Unemployment Relief Act was of general application throughout the entire Territory including military reservations. A few of the authorities were reviewed and the writer pointed out the distinction between lands purchased from a state with the consent of the State Legislature and lands acquired by the Federal Government within a Territory.

Because of the conflict in the opinions from this Department and the doubt expressed in the opinion letter of March 29, 1933 it seems desirable to re-examine all the cases in this field. We will review first the cases dealing with states, considering the possible applicability of these cases to military reservations in Hawaii, and then review the cases dealing with such reservations in territories.

B. *Decisions Relating to States.*

The Federal Government may acquire land by any one of the following three ways: (1) By purchasing the land with the consent of the State Legislature, (2) by exercise of its power of eminent domain, and (3) by cession from foreign countries. By each of the three methods the United States acquires a proprietary interest or title in the land. When the land to which the United States has thus acquired title is located within the borders of a state, the question arises whether the United States has exclusive legislative jurisdiction over

such lands or whether the United States shares concurrent legislative jurisdiction with the State in which the land is located. The question of jurisdiction depends on the manner in which the United States acquires its title or proprietary interest in the land, and the resulting jurisdiction differs with each method.

(1) *Land purchased with the consent of State Legislature.*

Where the Federal Government purchases land with "the consent of the Legislature of the State in which the same shall be, for the erection of forts, magazines, arsenals, dock-yards, and other needful buildings" the Federal Government shall enjoy exclusive legislative jurisdiction. This exclusive jurisdiction is conferred by Art. 1, sec. 8, cl. 17 of the United States Constitution—*U. S.* vs. *Cornell,* 2 Mass. 60; *Commonwealth* vs. *Clary,* 8 Mass 72; *Opinion of the Justices,* 1 Mete. (Mass.) 580; *Sinks* vs. *Reese,* 19 Ohio St. 306; *Western Union* vs. *Chiles,* 214 U. S. 278, 53 L. Ed. 997; see *Annotation—"Territorial* jurisdiction of State or Federal courts over lands within State acquired by United States"—74 L. Ed. 761; *Surplus Trading Co.* vs. *Cook,* 281 U. S. 647, 74 L. Ed. 1091.

(2) *Where land is acquired by United States government by exercise of its power of eminent domain.*

In these cases the transaction does not come within the language of the Constitution as there is no *purchase* by the Federal Government. In such a case although the state does not lose its legislative jurisdiction it cannot exercise its jurisdiction in such a way as to destroy or impair the effective use of the United States by interfering with the instrumentalities of the latter located on such land. *Kohl vs. U. S.,* 91 U. S. 367, 23 L. Ed. 449;

U.S. vs. Jones, 109 U. S. 513, 27 L. Ed. 1015; *Matter of Petition of U. S.,* 96 N. Y. 227.

(3) *Where the land in a State is owned by the United States at the time the State enters the Union and the State later cedes jurisdiction to the United States,*

In such instances the terms of this cession by the State to the United States, to the extent they may lawfully be prescribed, will control the question of whether the jurisdiction of the United States is exclusive or concurrent. This was first recognized in *Fort Leavenworth R. R. Co.* vs. *Lowe,* 114 U. S. 525, 29 L. Ed. 761, which is the leading case in this field. The opinion of Mr. Justice Field points out that the extent of the jurisdiction of the Federal Government is dependent on the terms of the cession, as there is no "*purchase*" by the United States Government to bring the transaction within the language of the United States Constitution—Art. 1, sec. 8, cl. 17. This case has been followed in: *Chicago etc. Ry. vs. McGlinn,* 114 U. S. 542, 29 L. Ed. 270; *Benson vs. U. S.,* 146 U. S. 325, 36 L. Ed. 991; *Palmer vs. Barrett,* 162 U. S. 399, 40 L. Ed. 1015; *Crook vs. Old Point Comfort Hotel Co.,* 54 Fed. 604.

The holding of these cases is based upon the theory that the United States has the proprietary interest in the land at all times; that when the Territory in which the land is located becomes a state the State has jurisdiction over the land; and that when the State cedes this jurisdiction to the United States it does so as a favor and hence can attach any conditions to the cession, providing the conditions do not interfere with the proper exercise of functions of federal instrumentalities located on that land. Whether this rule is applicable to territories, especially to the Territory of Hawaii will be discussed later, infra.

Four recent cases on this general subject merit particular attention.

Arlington Hotel Co. vs. *Faunt,* 278 U. S. 438, 73 L. Ed. 447 (Jan. 1929), involved the situation found in *Ft. Leavenworth* vs. *Lowe, supra.* Mr. Chief Justice Taft purported to follow the decision laid down in the *Lowe* case, which was careful to point out that the constitutional provision had no bearing on the problem and that the extent of Federal jurisdiction depended on the terms of the cession. In the opinion Mr. Chief Justice Taft showed that the cession of the State was absolute.

In United *States* vs. *Unzeuta,* 281 U. S. 138, 74 L. Ed. 761, the court followed the Lowe decision by interpreting the terms of a cession similar to that of Ft. Leavenworth.

In *Surplus Trading Co.* vs. *Cook,* 281 U. S. 647, 74 L. Ed. 1091 (1929), the land in question was purchased by the United States from Arkansas with the consent of the State. The court held that the Constitution conferred exclusive jurisdiction in the Federal Government. The opinion in this case, by Mr. Justice Van Devanter, indicates a clear understanding of the previous cases and the court is careful to distinguish the cases involving the Constitution, the cases involving cession without purchase, and the cases involving land in territories.

The most recent case is *Standard Oil Co.* vs. *California,* 291 U. S. 242, 78 L. Ed. 775. Mr. Justice McReynolds does not cite the clause in the Constitution but rests his decision on the three cases discussed above. The California Supreme Court had dismissed the question of jurisdiction with very little discussion.

For an excellent summary of the question of jurisdiction as it applies to *states* see the first part of Mr. Justice Van Devanter's opinion in *Surplus Trading Co,* vs. *Cook, supra.*

C. Decisions Relating to Territories.

In reviewing the cases dealing with the jurisdiction of territories over lands owned by the Federal Government located within the external boundaries of the territory we shall take First the two cases decided by the Supreme Court of Hawaii, then the cases cited in those decisions, and finally other cases on the same subject not mentioned in the Hawaii decisions.

In *Territory* vs. *Carter,* 19 Haw. 198, it was held that the territorial courts have jurisdiction of misdemeanors committed on lands reserved by the United States for naval purposes. The land in question was ceded by the Republic of Hawaii to the United States and accepted by the Newlands Resolution approved July 7, 1898. On November 10, 1899 a parcel of land including the one in question was reserved by the President of the United States for naval purposes "subject to such legislative action as 'the Congress of the United States may take with respect thereto". The court refused to accept the contention of the defendant that Art. 1, sec. 8, cl. 17 of the United States Constitution applied to this land. The court also refuted the argument that when land subject to the Newlands Resolution and to Section 91 of the Organic Act are set aside by Presidential Proclamation that the Territory is thereby divested of its jurisdiction over such lands. The court rested its decision on Section 81 of the Organic Act which provides that "until the legislature shall otherwise provide the laws of Hawaii heretofore in force concerning the several courts and their *jurisdiction* and procedure shall continue in force except as herein otherwise provided". The Organic Act not having "otherwise provided" the court followed the decisions in *Territory* vs. *Burgess,* 8 Mont. 57, and *Reynolds* vs. *People,* 1 Colo. 179.

In *Cassels* vs. *Wilder,* 23 Haw. 61 (1915), the court held that the Territory had jurisdiction to tax the personal property of a resident on a United States mili-

tary reservation (Schofield Barracks). The court rested its decision on the grounds of "stare decisis", citing cases which decided the question of the jurisdiction of territories over federal land in criminal, civil, and tax matters. The cases cited in the above decisions will be reviewed seriatim.

Territory vs. Burgess, 8 Mont. 57, 1 L. R. A. 808, 19 Pac. 558 (1888), held that the courts of the Territory of Montana had jurisdiction to try the defendant for murder committed on a United States militarv reservation situated in the Territory. The court after reviewing the case of *U.* S. vs. *McBratney,* 104 U. S. 621, and similar cases says: "These cases—all grow out of conflicts between jurisdiction of the *State* and Federal courts. They therefore shed but little light upon the immediate question we are called upon to decide, which is as to the jurisdiction of one or the other branch of the *territorial* courts. The court then points out that although *Scott* vs. *U. S.,* 1 Wyo. 40, reaches the conclusion that the territorial courts had no jurisdiction in such cases, it dissents from this view. After reviewing provisions of the Montana Organic Act similar to provisions in the Hawaiian Organic Act the court said: "* * * we are cited to no authority—which holds that the mere occupancy and use of a portion of the public domain as a military reservation, of itself, divests the territorial law or the territorial court of operation within the territory thus reserved." Of the effect of Presidential Proclamation on the question of jurisdiction the court quotes from 7 Op. U. S. Att'y Gen. 574, "A military reservation is an act of the President, under authority of law, withdrawing so many acres of the public domain from the immediate administration of the Commissioner of Public Lands, that is, from sale at public auction and by pre-emption or general private entry, and appropriating it for the time being to some special use of the government", and at p. 563 "The fact that a crime is

committed upon a military reservation established within a Territory does not give the federal courts jurisdiction of such crime; but the same remains within the jurisdiction of the territorial courts."

The court approves the contention of the Attorney General of Montana that "* * * the courts of the Territory derive their existence and jurisdiction from an Act of Congress; and, if this jurisdiction has not been taken from them, they still possess it. * * * But* * *we prefer resting our discussion upon the grounds stated: that the jurisdiction of the United States over a military reservation is not exclusive, and does not deprive the territorial laws and courts of the jurisdiction conferred on them by law".

Reynolds vs. People, 1 Colo. 179, upheld the jurisdiction of the Territory of Colorado to license liquor dealers on United States military reservations. The court points out that the jurisdiction of the territorial and federal governments is concurrent; and that the territory's jurisdiction is not excluded from the military reservation but rather limited to a sphere which would not interfere with the federal government. See also *Torrey* vs. *Baldwin,* 3 Wyo. 430, 26 Pac. 908; *Moore* vs. *Beason,* 7 Wyo. 292, 51 Pac. 875; *Rice* vs. *Hammond,* 19 Okla. 419, 91 Pac. 698.

There is an analagous line of cases involving the jurisdiction of territories over lands which had been set aside by the Federal Government for Indian reservations. In many of these cases the result is complicated by provisions in treaties between the United States and the Indian tribes. However, where this complication is absent the rule of law is well established that the Territory has jurisdiction to tax persons and property, other than Indians, located within these reservations. Such a result was reached in *Territory* vs. *Delinquent Tax List,* 3 Ariz. 302, 26 Pac. 310 (1891). The court in an elaborate and well reasoned opinion rests its deci-

sion on *Langford* vs. *Monteith,* 102 U. S. 145 and after distinguishing the cases relating to states (both types as discussed above) concludes that as to territories the rule is different.

Also relating to Indian reservations is the case of *Noble* vs. *Amoreti,* 11 Wyo. 230, 71 Pac. 879 (1903). This case upholds the same rule of the taxability of property of other than Indians on Indian reservations. The case points out that the earlier Wyoming decisions holding to the *contrary—Moore vs. County Commrs.,* 2 Wyo. 8, and *Fremont Co. vs. Moore,* 3 Wyo. 200, 19 Pac. 438—were overruled by the decision in *Torrey vs. Baldwin,* 3 Wyo. 430, 26 Pac. 908, and this latter decision was followed in *Moore vs. Beason,* 7 Wyo. 292, 51 Pac. 875.

The Supreme Court of Hawaii in the instant case relies on the decisions of *Thomas vs. Gay,* 169 U. S. 264, 42 L. Ed. 740, *Wagoner vs. Evans,* 170 U. S. 588, 42 L. Ed. 1154 and *Truscott vs. Hurlburt Co.,* 19 C. C. A. 374, 73 Fed. 60. See also *Gay vs. Thomas,* 5 Okla. 1, 11, 46 Pac. 578, and same case, 7 Okla. 184.

See also: *Utah Northern Ry. vs. Fisher,* 116 U. S. 28, 29 L. Ed. 542; *Clairmont vs. U. S.,* 225 U. S. 551, 56 L. Ed. 1201.

The case of *Thomas vs. Gay,* 42 L. Ed. 740, involved another issue which is of importance to our inquiry. The court held that treaties between the United States and Indian tribes were superseded by an Act of Congress—namely the Act of Congress creating the Territory of Oklahoma—citing *Foster& Elam vs. Neilson,* 2 Pet. 314, 7 L. Ed. 435, and *Taylor vs. Morton,* 2 Curt. C. C. 454, and *The Cherokee Tobacco* 78 U. S. 11 Wall. 616, 20 L. Ed. 227.

The case of *Gromer vs. Standard Dredging Co.,* 224 U. S. 362, 56 L. Ed. 801, throws considerable light on our inquiry. The headnote of the case declares that

"jurisdiction for taxing purposes of the harbor areas and navigable waters within defined limits of Porto Rico was not denied the insular government by the reservations of such areas and waters in favor of the United States, made by (Acts of Congress) which must be construed as *proprietary* reservations only, and not as limitations upon the exercise of government." By construing the Acts of Congress the court concluded that the United States did not reserve governmental control but merely retained title to the land in question thereby giving to Porto Rico governmental control, including the jurisdiction to tax.

The court cites with approval an opinion of Solicitor General Hoyt, 26 Op. U. S. Att'y Gen. 91, 97 which considered the question of the jurisdiction of the Philippine government over a naval reservation set aside by an executive order similar to executive orders setting aside the military reservations in Hawaii. The opinion concludes that the jurisdiction of the Navy Department over reservations "is not of such character and extent as to exclude the civil powers of the Philippine Government relating to the *imposition of taxes, etc.* and in general the exercise of such civil rights as do not interfere with the naval uses of the reservation."

Although the question of the jurisdiction of the Territory to tax property located on military and naval reservations in Hawaii was settled in *Cassels* vs. *Wilder, supra,* we feel that after a review of the authorities on which this decision was based that the conclusion reached by the court rests on a firm foundation.

That the rule concerning *jurisdiction* does not differ because of the nature of the tax involved see *Nikis* vs. *Commonwealth,* 131 S. E. (Va.) 236, 46 A. L. R. 219, where the Supreme Court of Virginia upheld the imposition of a license tax on the business conducted on land owned by the Federal Government, by an individual. Although the precise ground of the decision rested on a

construction of Art. 1, sec. 8, cl. 17 of the United States Constitution the tax upheld was a license (excise) tax and not a personal property tax.

II. *Federal Instrumentalities,*

From the above discussion it is clear that the Territory of Hawaii has jurisdiction to tax property or activities located on or carried on within a military reservation. However, this jurisdiction to tax can be exercised only so far as the exercise of this taxing power does not interfere with the exercise of federal functions carried out through federal instrumentalities. We are therefore faced with our second inquiry: Is a post exchange a federal instrumentality of the character exempt from taxation by the Territory of Hawaii?

A. *Nature of Post Exchanges,*

The post exchanges are organized under Army Regulations 210-65 published June 29, 1929 as amended by A. R. 210-65, C 2 published October 20, 1933. These Army Regulations provide for the organization, membership, personnel, management and administrative functioning of the post exchanges. The principal features of the Army Post Exchanges are described and summarized in *People vs. Standard Oil Co.*, 22 P. (2d) (Cal.) 2, 3:

"The commanding officer of an army post is not required to organize the post exchange unless there is need for it or unless the units present desire to participate therein or unless the personnel is sufficint to profitably maintain and support such an institution. In other words, a post exchange is at most but a government agency, designed to operate for the welfare of the troops such activities as a general store, meat or vegetable market or gasoline station, or a restaurant, gymnasium, recreation room, library, or theater. Thus it is not properly described by the word 'department' of the government in its activities. It is largely a co-operative institution, intended to supply the needs and promote the moral and civic betterment of the troops at the post.

"It is supervised by an exchange council, composed of the commanding officers of the respective units represented in the organization. The funds of the exchange are not public moneys within the meaning of the Revisd Statutes of the United States (Rev. Stats. Sections 5488, 5490, 5492, 18 USCA Section 173, 175, 177). The exchange is not instituted by the aid of funds from the United States nor are its avails paid into the treasury. It is a voluntary, unincorporated, co-operative association in which all units share the benefits and all assume a position analogous to that of partners. In the event of the inability of the post exchange to pay its debts, the organizations which participate in it are supposed themselves to pay off all such obligations in proportion to their respective interests in the exchange. Neither the government nor the officers of the post wherein the exchange is located are liable for its debts. The property of the post exchange is not to be treated as property belonging to the United States. The exchange itself is liable for certain federal taxes, such as the stamp tax imposed by the Internal Revenue Act, the freight tax imposed by the War Revenue Act of 1917 (40 Stat. 300), a floor tax on tobacco under the Revenue Act of 1918, Section 702 (40 Stat. 1118); sales of ice cream and soft drinks by a post exchange are subject to tax under the same act. From these and other observations that might be made, touching the nature of the organization of an army post exchange, we are of the opinion that it is an organization largely engaged in business of a private nature and that sales to it should not be beyond the reach of the taxing power of the state where it is located and that it is not one of those agencies through which the federal government directly exercises its constitutional or sovereign power."

B. *Legal Authorities Describing the Nature and Status of Post Exchanges.*

The question of whether post exchanges are federal instrumentalities is not a new one. This inquiry has been before the courts on numerous occasions and the courts have reached different conclusions which cannot be entirely reconciled. We have, therefore, a conflict of authority and we must determine which line of cases to follow.

The leading case holding that a post exchange is a federal instrumentality, is *Dugan* vs. *United States*, 34 C. Cl. 458 (1899). The question before the court was whether a post exchange was a government agency, and hence immune from federal taxes, on the theory that it was not the policy of the federal government to

tax its own enterprises. The court found that a post exchange was an agency of the federal government saying at page 466.

"If, therefore, in the judgment and wisdom of the Executive the establishment of such post exchanges and their management by officers of the Army are essential to the welfare, good order and discipline of the troops stationed at such army posts, as seems evident from the exchange regulations thus promulgated, then we think such exchanges, though conducted without financial liability to the Government, are, in their creation and management government agencies * * *."

This opinion has been frequently quoted and the decision uniformly followed in Opinions of the Judge Advocate General. See Op. J. A. G. O. 120, December 2, 1919, p. 465; Op. J. A. G. O. 12, 412, Sept. 25, 1923. See also Letter from Secretary of the Treasury to the Secretary of War dated Dec. 2, 1932 (A. G. 012.33).

It should be pointed out that in the *Dugan* case the court makes certain pertinent observations which are grounds for distinguishing this decision as it applied to the Post Exchange of 1899 and as it would apply to the Post Exchange of 1935.

At page 462 the court points out that the post exchanges "superseded the 'canteens', which were organizations in the nature of social clubs, voluntarily formed by the officers of a regiment or other command with their own money and conducted independently of their offiicial duties * * *". These canteens were liable for internal revenue taxes because they were not federal instrumentalities.

In describing the post exchanges of 1899 the court said at page 462 "Under Post Exchange Regulations (of July 25, 1895) post exchanges were established and the *commanders at every post thereby required to institute the same* * * *".

And again at page 467: "* * * and while such exchanges so established are for the manifest benefit of

the troops constituting such exchanges, *yet there is nothing in the regulations looking to the consent of the members thereof as a pre-requisite to their establisment.* On the contrary, they provide that 'post exchanges are established and maintained under special regulations prepared by the War Department,' and by the second paragraph thereof it is provided that *'at every post, where practicable, the post commander will institute a post exchange'* * * *".

The Army Regulations under which post exchanges operate today (A. R. 210-65, June 29, 1929 as amended Oct. 30, 1933) do not *require* the establishment of a post exchange at every post. In section I, thereof, we find:

"1. *Establishment and maintenance.*

a. General—At each post, camp, or station the commanding officer will establish and maintain a post exchange whenever—

(1) There is a need for it

(2) There are organizations present that desire to participate therein

(3) The personnel is sufficient to profitably maintain and support such an exchange."

This suggests that the post exchange is a voluntary organization rather than one *"required"* as under the regulations of 1895. The Army's own Judge Advocate General has recognized this voluntary feature:

"A post exchange is a *voluntary* unincorporated cooperative association of Army organizations, a kind of cooperative store, in which all share in the benefits and all assume a position analogous to that of partners * * * ". Ops J. A. G. June 4, 1918.

The Court of Claims in the *Dugan* case seemed to be impressed by the compulsory nature of post exchanges under the Army Regulations of 1895 and relied on this factor to distinguish the post exchange from the "canteen". Under present regulations the voluntary feature found in the "canteen" seems to be present in the organization of the post exchange, and this seems in itself to be sufficient grounds to make the *Dugan*

case inapplicable to the present day post exchange.

The *Dugan* case, whether applicable or not to the present day post exchange, is not the only judicial guide to be reckoned with in our search for the answer to the question of whether post exchanges are federal instrumentalities. We encounter several cases squarely opposed to the conclusions reached in the *Dugan* case,

In *Olsen & Co.* vs. *Rafferty,* 39 Philippine Rep. 464 (19 19), the court held that goods sold to the Army Post Exchanges and Navy Ship's Stores were not goods sold directly to the United States Army or Navy for actual use or issue by the Army and Navy. The court held that the goods were sold for the use and benefit of the post exchanges etc., and not for the actual use or issue by the Army or Navy. In reaching such a conclusion it was necessary that the court find that Army Post Exchanges and Navy Ship's Stores were not so intimately connected with the Army or Navy as to be federal instrumentalities. The court in reaching its conclusion was particularly impressed by the fact that the funds used by these institutions to purchase goods were not funds of the United States. Nor did the money received by post exchanges and ship's stores from the sale of these goods become a part of the general funds of the Army or Navy.

Thirty-First Infantry Post Exchange vs. *Posadas,* 54 Philippine Rep. 866 (1930), held that the Philippine Government could impose a sales tax on sales by merchants to Post Exchanges of the United States Army located in the Philippines. The decision rests on several grounds (1) the long acquiescence in the imposition of the sales tax on such sales; (2) the Congress of the United States had virtually sanctioned the tax by confirming the Philippine revenue laws without reservation; (3) post exchanges, even if federal agencies are engaged in business of a private nature and hence represent the exercise of a proprietary rather than a governmental function of the United States; (4) the

tax affects the United States Army only indirectly; (5) the post exchanges are not a federal instrumentality.

In reaching the conclusion that the tax was validly imposed the court makes certain observations worth noting. In discussing the limitations to the exemption of federal instrumentalities from state taxation the court says at page 874:

"The effect of the tax upon the functions of the Government and the nature of the governmental agency determine finally the extent of the exemption * * * ".

Later at page 876 we find:

"When a merchant sells a case of hair pins to an Army post exchange, and the wife of an Army officer purchases a package of those hair pins, and when a merchant sells a quantity of tobacco to an Army post exchange, and a soldier provides himself with his tobacco; and when the merchants who, perfect the sales make good the required taxes, 'the exertion of national power' is not so burdened or interfered with, and 'the exactions demanded' do not so infringe the constitutional independence of the United States as to exempt the sales from taxation, which everyone else, including the merchant who sells to the Philippine Government, must pay. That is our understanding of the authorities and of the law. "

Keane vs. *United States,* 272 Fed. 577 (1921), held, as summed up by the headnote, that: "A military post exchange, which is a voluntary association of companies, detachments, or other army units at military posts, permitted, but not required, by a special regulation of the War Department for the purpose of conducting for the benefit of the members of such units what is in effect a cooperative store and place of entertainment, with their own funds, and for whose contracts and obligations the United States is not responsible, and in whose funds it has no interest, though its business is conducted by an officer detailed for the purpose, held not a 'department of the government', and proof of a conspiracy to defraud a post exchange held not to sustain an indictment under Criminal Code, section 37

(Comp. St. section 10201) for conspiracy to defraud the United States."

The court in finding that a post exchange is not a governmental agency pointed out the following facts: (1) That post exchanges are voluntary organizations and are not required to be formed, (2) that the federal government does not assume the debts or claim the profits of post exchanges, (3) that "post exchanges are such purely private organizations for the convenience and pleasure of the soldiers themselves that they have been required to pay floor taxes on tobacco under the * * * Revenue Act of 1919", (4) that the regulations of the Secretary of War do not turn a private enterprise into a governmental agency because the Secretary of War is without power to do so.

In *People* vs. *Standard Oil Co.,* 22 P. (2d) (Cal.) 2 (May 1933) the Supreme Court of California held that sales of gasoline to an Army Post Exchange located at the Presidio Military Reservation were not exempt under the terms of the state act imposing a license tax on distribution of gasoline, which act exempted fuel sold to the Government of the United States or any "department of the United States Government" for its official use.

The court, in the passage quoted earlier in this opinion, described the nature of post exchanges and concluded that they were not the kind of federal instrumentality which is immune from state taxation.

The tax upheld in this case was a license (excise) tax measured by sales and is similar to the tax imposed by the Territorial Gross Income Tax.

The fact that this decision was overruled by the United States Supreme Court in 291 U. S. 242, 78 L. Ed. 775, in no way weakens its authority on the question of the status of post exchanges. The United States Supreme Court found that California had no jurisdiction to impose the tax in question but as shown in Topic I, above, the question of jurisdiction as applied to the Territory of Hawaii involves different considerations. The California Supreme Court's decision relative to the status of post exchanges remains unimpeached.

In *Pan American Petroleum Corp. vs. State of Alabama*, 67 F. (2d) 590 (Nov. 1933), the United States Circuit Court of Appeals, Fifth Circuit, held that although the State of Alabama could not impose an excise tax on the sales of gasoline as to sales to the United States directly, or indirectly through one of its departments for governmental use, yet sales of gasoline to post exchanges on United States military reservations were not exempt from such a tax.

At page 591 the court said:

" * * * Furthermore, a post exchange is, of course, not the government; nor is it a department or instrumentality thereof. On the contrary a post exchange is a voluntary, unincorporated cooperative association of army organizations in which all share as partners in the profits and losses. The government has no part in the profits, and is not bound by the losses. We are therefore of the opinion that sales made try apellant to the post exchanges at Camp McClellan and Maxwell Field are not exempt from the state excise taxes," citing People vs. Standard Oil Co., 22 Pac. (2nd) 2.

This case was appealed to the Supreme Court of the United States where *certiorari* was denied in 54 Sup. Ct. Rep. 454, 78 L. Ed. 1060.

It is clear from the authorities discussed above that post exchanges are not federal instrumentalities of the kind protected by the United States Constitution from state and territorial taxation. It is true that the decisions in all these cases were not those of a unanimous court. It is also true that the *Dugan* case, though distinguishable, contains strong language to the effect that post exchanges are federal instrumentalities. However, in the three most recent cases, all decided since 1930, the courts have held that post exchanges are not federal instrumentalities. The reasons given in these cases for

finding that post exchanges are not government agencies are very persuasive and we feel bound to follow the conclusions reached by these courts. In so deciding, we are not unmindful of the part played by post exchanges in Army life. However, "the question here is not whether a post exchange is useful and pleasurable to soldiers, and therefore to the Army, but the question we must decide is whether or not a post exchange is such a lawful department of the government as to bring it within the protection" of the United States Constitution which exempts certain federal instrumentalities from territorial taxation. (Quotation from *Keane* vs. *U. S.*, 272 Fed. 577, 583).

III. *Specific Application of the Gross Income Tax.*

The provision of the General Excise Tax dealing with Federal Agencies reads as follows:

"Section 3.—In computing the amounts of any tax imposed under this Act, there shall he excepted from the gross proceeds of sales or gross income, so much thereof as * * * is derived from any sales made to the United States government, its departmcnts or agencies, *which is,* or may hereafter be *exempted from taxation under the Constitution of the United States or the Organic Act of the Territory;* provided, however, that if and when the Congress of the United States shall permit the Territory of Hawaii to impose a privilege tax upon gross proceeds of sales or gross income derived * * * from sales made to the United States government, its departments or agencies, in * * * such event the exceptions and exemptions by this Section provided, shall not apply."

This section is a statutory declaration of a well established principle of constitutional law. Were section 3 omittedfrom the Gross Income Tax Act the Territory would nevertheless be without power to tax federal instrumentalities. By including this section in the Act the legislature did not enlarge the exemption. An examination of the wording of section 3 discloses that there is exempt from the operation of the Act the gross income derived from "any sales made to the United States

government, its departments or agencies, which is * * * *exempted from taxation under the Constitution of the United States or the Organic Act of the Territory* * * *".*

The Organic Act contains no specific provision exempting federal instrumentalities from territorial taxation.

Section 5 of the Organic Act extends the Constitution of the United States to the Territory of Hawaii.

Section 55 of the Organic Act conferred upon the local legislature the power of taxation "with all the completeness and effectiveness with which that power is vested in and exercised by the legislature of any of the states." *In re Craig,* 20 Haw. 483, 490; see also *Peacok* vs. *Pratt.* 121 Fed. 772, *In re Kalana,* 22 Haw. 96, 103.

The only limitations upon the exercise by the Territory of its power of taxation are those limitations contained in the United States Constitution. The rule as to territories is contained in *Domenech vs. National City Bank,* 79 L. Ed. (Adv. Ops.) 370, where the United States Supreme Court said at page 373:

"Puerto Rico, an island possession, like a Territory, is an agency of the federal government having no independent sovereignty comparable to that of a state in virtue of which taxes may be levied. Authority to tax must be derived from the United States. But like a state, though for a different reason, such an agency may not tax a federal instrumentality. A state, though a sovereign, is precluded from so doing because the Constitution requires that there be no interference by a state with the powers granted to the federal government. A territory or a possession may not do so because the dependency may not tax its sovereign."

This statement of the rule needs no further amplification. The Territory of Hawaii is bound by the same constitutional limitations in exercising its taxing powers as apply to the states. Although the reason for the limitation is based on a different theory the limitation is nevertheless the same. We are therefore confronted with the question, what are the federal instrumentali-

ties which the Territory is forbidden to tax by the United States Constitution ?

"Just what instrumentalities of either a state or the federal government are exempt from taxation by the other, cannot be stated in terms of universal application. But this court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other." *Metcalf vs. Mitchell,* 269 U.S. 514, 522, 70 L. Ed. 384, 391.

Under the cases cited in Topic 11, B, *supra,* post exchanges would seem to be closely analogous to a type of federal licensee which enjoys a federal privilege, but which privilege is held not sufficient to exempt the holder of the privilege from state taxation. See *Susquehanna Power Co. vs. Tax Comm.,* 283 U. S. 291, 75 L. Ed. 1042; *Federal Compress & Warehouse Co. vs. McLean,* 291 U.S. 17, 78 L. Ed. 622; Trinity Const. Co. vs. *Grosjean,* 291 U. S. 466,78 L. Ed. 918. See also *Wheeler Lumber Co. vs. U. S.,* 281 U. S. 572, 74 L. Ed. 1047; and *Baltimore Shipbuilding Co.* vs. *Baltimore,* 195 U. S. 375, 49 L. Ed. 242.

It is unnecessary to lengthen this opinion by a repetition of the cases cited and discussed under Topic 11, B, *supra.* Although it is a close question, the weight of authority holds that post exchanges are not federal instrumentalities immune from territorial taxation. There is nothing in the Gross Income Tax Act itself to limit its application beyond those limitations imposed by the United States Constitution, and we therefore hold that sales to post exchanges must be included in the measure of the tax of the seller who is subject to the terms of the Act. Furthermore, as the post exchange is not a federal instrumentality, it is subject to the Gross Income Tax Act and must comply with all the provisions thereof.

The other transactions mentioned by you are *a fortiori* subject to the provisions of the Gross Income Tax Act.

A word should be said of the attempts to gain exemption found in examples 1 and 2 of the hypothetical facts submitted by you. Irrespective of the questions of jurisdiction and immunity of federal instrumentalities these examples show a clear and conscious attempt on the part of the merchant to convert a taxable transaction into an exempt transaction. The scheme lacks the ingenuity of a similar attempt to convert a taxable transaction into a nontaxable transaction which was found to be spurious and condemned by the United States Supreme Court in *Superior Oil Co.* vs. *Mississipi,* 280 U. S. 389, 74 L. Ed. 505. The sale in each of the examples was a sale to an individual and such individual acting in a private capacity is not an instrumentality of the federal government. Whether the purpose of the merchant in collecting through the post exchange is to evade taxation or facilitate collection of the account is immaterial. Neither the collecting through nor the billing of the post exchange will convert such a sale into a nontaxable transaction.

Supplementary Grounds for Holding Sales to or by Post Exhanges Taxable under the General Excise Tax Law.

Although the reasons given above are sufficient to sustain the conclusions reached in this opinion we should like to mention briefly two supplementary grounds to sustain the taxability of sales to post exchanges and sales by post exchanges.

1. Post Exchanges are Performing a Proprietary Function of the Federal Government.

It is unnecessary to find that the Post Exchange is not a federal instrumentality if in its operation it performs a proprietary rather than a governmental function of the federal government. One of the findings of the Philippine Supreme Court in *31st Infantry Post Ex-*

change vs. *Posadas, supra,* was that the Post Exchange performed a proprietary function. There are ample facts to support this finding, *viz,* the activities of the Post Exchange in operating a general store, a meat market, a vegetable market, a gasoline service station, a restaurant, a gymnasium, a recreation room, a library, a theater, and, it might well be added, a collection agency.

Where the government engages in business of a private nature, the agency by which it performs this nongovernmental business is not immune from taxation. See *South Carolina* vs. *U. S.,* 199 U. S. 437, 50 L. Ed. 261 ; *Ohio* vs. *Helvering,* 292 U. S. 360, 78 L. Ed.1307. But see *caveat* in 8 N. I. T. M. 91, 93.

2. *The Nature of the General Excise Tax Law Permits the Inclusion of Sales to Post Exchanges in the Measure of the Tax.*

Section 2-1 of the General Excise Tax Law declares that:

"There is hereby levied and shall be assessed and collected annually privilege taxes against persons on account of their business * * * in this Terriotry measured by the application of rates against * * * gross proceeds of sale or gross income * * * as follows * * * ."

The tax thus imposed is a tax the subject of which is the privilege of doing business, the measure of which the gross proceeds of sale multiplied by certain specified rates. It is not a tax on the sale but a tax on the privilege of doing business. This is an important feature in view of the decisions of the United States Supreme Court, which have established the rule that where the tax is on a proper subject it is valid even though the tax may be measured by elements of value that cannot be named as the subject of the tax.

Thus the court has allowed a state to tax the privilege of doing business in corporate form though included in the measure of the tax are investments in United States Government bonds. It is well settled that

a state cannot tax the obigations of the United States, yet it can include these obligations in the measure of a tax which is laid on a proper subject. *Home Insurance Co.* vs. *New York,* 134 U. S. 594,33 L. Ed. 1025; *Flint* vs. *Stone Tracy,* 220 U. S. 108, 55 L. Ed. 389; *Educational Film Corp.* vs. *Ward,* 282 U. S. 379, 75 L. Ed. 400; *Pacific Co.* vs. *Johnson,* 285 U. S. 480, 76 L. Ed. 893.

If the General Excise Tax Law imposed a tax on the sale and not on the privilege of doing business then the above cases would be inapplicable. *Panhandle Oil Co.* vs. *Mississippi,* 277 U. S. 218, 72 L. Ed. 857; *Indian Motorcycle Co.* vs. *United States,* 283 U. S. 570, 75 L. Ed. 1279.

The *Indian Motorcycle Co.* case held that a federal sales tax could not be validly imposed on a sale to a state government. The court intimated that had the tax been on the privilege of doing business measured by sales, rather than on the sale itself, the tax would have been upheld. See 75 L. Ed. 1280, 1281.

Regardless of the grounds for upholding the validity of the imposition of the General Excise Tax Law, on merchants who sell to post exchanges, it is clear that the sales to post exchanges must be included in the measure of the tax of such merchant.

However, we prefer to rest this decision on the grounds that post exchanges are not federal instrumentalities and this results in all of the transactions mentioned in your hypothetical facts being subject to the General Excise Tax Law.

Respectfully,

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APPROVED:

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