TERRITORY OF HAWAII

DEPARTMENT OF THE ATTORNEY GENERAL

HONOLULU

45, C-5226, C-4539(2), C-4985

January 16, 1941

Note: Copy of this opinion filed under heading of "Cost-Plus-Fixed Fee Contracts."

OPINION NO. 1762

TAXATION; GROSS INCOME TAX; FEDERAL CONTRACTORS:

The proceeds from equipment purchased by the United States as a part of and incidental to the naval air base contract NOy-3550, under the authority of Section 4 (a) of Public No. 43, 76th Congress, 1st Session, c. 87, should be taxed the same as other proceeds of the construction contract.

SAME; SAME; UNITED STATES:

In view of recent cases in the Supreme Court of the United States and the position taken by the Attorney General of the United States the gross income tax imposed by Act 141 (Ser. A-44) L. 1935 might be applied to the proceeds from the equipment furnished to the United States even if the transaction were viewed as an ordinary purchase of commodities.

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

Dear Sir:

In our opinion of September 18, 1940 (Op. Atty. Gen. No. 1740) the question as to the application of the gross income tax (Act 141 (Ser. A-44) L. 1935) in connection with equipment purchased by the United States was not covered,

as we requested further facts.

The question which we left open in our former opinion concerns equipment purchased outright by the United States which becomes government property and is inventoried as such, though furnished by the government for use in connection with the contract. You advise us that the procedure in the purchase of such equipment is the same as in the purchase of materials. Purchases are made without public advertisement regardless of amount.

As to the contention that the contractors are agents of the United States, which itself is making the purchases from the various manufacturers and jobbers through the contractors as agents, we have reached the same conclusion as was reached in our former opinion since the facts are the same. In our opinion the Contractors are purchasing the equipment and in turn furnishing it to the United States. The gross income tax applies to the sales to the Contractors at the wholesale rate of ¼ of 1%, and the tax applies to the amount received by the Contractors from the United States at the retail rate of l½%.

It should be noted that the equipment so purchased by the United States from the Contractors cannot be regarded

as in the same category as other commodities purchased by the United States. This equipment is purchased as incidental to a public works project, as a part of the cost of that project, under the authority of Section 4 (a) of Public No. 43, 76th Congress, 1st Session, c.87. Otherwise the purchases would have to be made through the regular channels, after public advertisement. Title 41 U.S. Code, Section 5; Title 34 U.S. Code, Sections 561 and 571. Therefore the general rule requiring that federal contractors pay the gross income tax upon the proceeds received by them from the United States (James v. Dravo Contracting Co., 302 U.S. 134) applies as well to the sums received from the United States for this equipment.

Moreover, in James v. Dravo Contracting Co., supra, the court stated as to Panhandle Oil Co. v. Knox, 277 U.S. 218, 72 L. Ed. 857, Indian Motorcycle Co. v. U.S. 283 U.S. 570, 75 L. Ea. 1277, and Graves v. Texas, 298 U.S. 393, 80 L. Ed. 1236:

> " * * * These cases have been distinguished and must be deemed to be limited to their particular facts * * *
>
> "* * * we are not bound to consider or decide how far immunity from taxation is to be deemed essential to the protection of Government in relation to its purchases of commodities or 'whether the doctrine announced in the cases of that character which we have cited deserves revision or restriction." (pp. 151, 153)

Again, in Helvering v. Gerhardt, 304 U.S. 405 82 L. Ed. 1427 (May 23, 1938) in denying the immunity from federal tax of the salary of the engineer of the New York Port Authority, the court cast further doubt upon the authority of the above cases involving tax immunity of sales to the states or United States. The court referred to Indian Motorcycle Co. v. United States, supra, the one case involving federal taxation, and said:

> "The reasoning upon which the decision in Indian Motocycle Co. v. United States, supra, was rested is not controlling here. Taxation of the sale to a state, which was thought sufficient to support the immunity there, is not now involved. Whether the actual effect upon the performance of the state function differed from that of the present tax we do not now inquire. Compare Wheeler Lumber Bridge & Supply Co. v. United States, 281 U.S. 572."

Finally, in Graves v. N.Y. ex rel O'Keefe, 306 U.S. 466, 481 (March 27, 1939), the case in which the court overruled the doctrine of immunity of federal employess from state taxes upon their salaries, the court abandoned any claim, of a distinction based on the type of transaction and squarely took the position that:

> "The theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable * * *"

citing among other cases the Dravo case. This construction of the Dravo case in the O'Keefe case, which itself exends

the field of taxation, coupled with the absence of any distinguishing differences between the performance of a construction contract for the federal government and the sale of commodities to it, tends to the conclusion that a gross income tax of the type and amount sustained in the Dravo case might also be applied to the sale of commodities to the United States. The Territory's tax is a tax of the same type as that involved in the Dravo case and is even less in amount than the West Virginia tax there involved.

The Attorney General of the United States has indicated that he construes the Dravo case as limiting Panhandle Oil Co. v. Knox, supra, and similar cases. The Attorney General has taken the position that federal officers "should take no part in any effort to prevent the collection" of territorial taxes imposed on the seller although the federal government or a federal instrumentality is the buyer. 39 Op. Atty. Gen. No. 85. That opinion related to the tobacco tax but is even more clearly applicable to the gross income tax, as will appear. The position thus taken by the Attorney General of the United States is of great importance in view of the following statement by the Supreme Court of the, United States in the Dravo case:

> "The defense is that the tax burdens the Government and respondent's right is at best a derivative one. He asserts an immunity which, if it exists, pertains to the Government and which the Government disclaims."

The view that the Dravo case has narrowly limited the doctrine of the immunity of sales to the government also finds support in the Department of Justice study of "Taxation of Government Bondholders and Employees - The Immunity Rule and the Sixteenth Amendment" page 12, and page 62, footnote 228, as pointed out in the opinion of the Attorney General or the United States, supra. Since the Dravo case the courts unanimously have been of the opinion that the Panhandle Oil Co. case, supra, and similar cases do not confer immunity on the seller from privilege taxes imposed upon him. Western Lithograph Co. v. State Board, 78 Pac. (2d) (Cal.) 731; Federal Land Bank v. De Rochford, 287 N.W. (N.D.) 522, 533; In re National Trunk & Luggage Mfg. Co., 33 Fed. Supp. (D.C. Cal.) 249.

The Comptroller General of the United States makes a distinction between an occupation or privilege tax of the type of our gross income tax and a sales tax which while imposed on the seller is in ultimate effect upon the buyer since required to be passed on to him. The Comptroller General sustains the validity of the former tax upon sales to the United States, but not the latter, pointing out that

the Dravo case involved the former type of tax and not the latter. 17 Comp. Gen. 863, 18 Comp. Gen. 832. The present matter concerns only the former type of tax, which is like our gross income tax. The latter type of tax, which is like our tobacco and liquor taxes, is not involved.

For all of the foregoing reasons we advise you to make no distinction between the proceeds from equipment purchased by the United States as a part of and incidental to the construction contract, under the authority of Section 4 (a) of Public No. 43, 76th Congress, 1st Session, c. 87, and other proceeds of the construction contract.

This opinion and the two opinions of September 16, 1940 (Nos. 1739 and 1740) deal only with the specific questions: (1) as to whether or not the Contractors are purchasing agents of the United States; (2) as to whether or not there is a distinction between equipment and materials incorporated into the contract job; (3) as to whether certain islands are within the Territory of Hawaii; and (4) as to the taxing jurisdiction of the Territory over federal reservations within the exterior boundaries of the Territory.

Respectfully,

Rhoda V. Lewis

Rhoda V. Lewis
Deputy Attorney General

APPROVED:

Attorney General