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TERRITORY OF HAWAII

DEPARTMENT OF THE ATTORNEY GENERAL

HONOLULU

June 15, 1951

OPINION NO. 1859

UNITED STATES; FEDERAL INSTRUMENTALITIES; TAXATION:

The Shipyard Restaurant System, consisting of federal civil service employees operating a food service under the supervision of the Shipyard commander, pursuant to Naval Civilian Personal Instructions 66, is, as stated in said regulations, a non-profit cooperative subject to territorial taxes; such organization is not protected by any implied governmental immunity.

SAME; SAME; SHIPYARD RESTAURANT SYSTEM:

The Shipyard Restaurant System, an organization of federal civil service employees having the use of federal property and acting under federal supervision in the operation of a food service, but without federal ownership of the food stocks or funds and without federal liability for obligations incurred, is not an integral part of the Navy Department or a wholly owned intrumentality.

SAME; SAME; SAME

By reason of the Act of December 6, 1945, the Navy is without power to create a separate and distinct entity that is a federal instrumentality, and Civilian Personnel Instructions 66 relating to Food Service has not purported to authorize the creation of such an entity.

TAXATION, GENERALLY:

A group of federal civil service employees associated together for the operation of a cooperative food service for their own welfare are not entitled to tax exemption on the benefits thus received any more than they are entitled to tax exemption on their salaries.

TAXATION, GROSS INCOME, NET INCOME, PERSONAL PROPERTY; COMPENSATION AND DIVIDENDS:

The territorial gross income tax and net income tax apply to the association known as the Shipyard Restaurant System, and withholding of the 2% Compensation and Dividends Tax from the compensation of Shipyard Restaurant employees is required. When the personal property tax was in effect it applied to property held by such association and not owned by the United States.

TAXATION, GROSS INCOME:

The Shipyard Restaurant System is not an organizatiozn operated for the benefit of the community; no exemption contained in the gross Income tax law applies to this organization.

TAXATION, NET INCOME:

No exemption contained in the net income tax law applied to the Shipyard Restaurant System prior to Act 166 of the Session Laws of 1951. Commencing with the tax year 1952, on 1951 income, it is exempt as a “local association of employees” meeting the requirements for exemption set forth in the amended law.

TAXATION, COMPENSATION AND DIVIDENDS TAX:

The Shipyard Restaurant System is not a federal instrumentality, but even if it were an entity having that status it would not thereby be relieved of the duty of withholding the 2% tax from the compensation of employees.

Honorable Torkel Westly
Tax Commissioner
Honolulu, T. H.

Dear Sir:

This opinion concerns the following pending matters:

(1) A claim for refund to "Shipyard Restaurants, U. S. Naval Shipyard, Pearl Harbor" of net income taxes in the amount of $2,106.97 paid in 1947 on income of the year 1946. By Act 300 of the Session Laws of 1951 the legislature made an appropriation for such refund conditioned however as follows:

> "This amount shall be paid to the said claimant only if the attorney general of the Territory shall issue an opinion to the effect that the taxes were not properly collectible or payable."

Collectibility of further net income taxes also is involved.

(2) A claim for refund to said "Shipyard Restaurants, U. S. Naval Shipyard, Pearl Harbor" of personal property taxes in the amount of $716.54, paid in 1947 on property returned for taxation as of January 1, 1947. In said return the property listed as taxable, on which the tax was paid, was inventory of stock in trade in the amount of $33,523.00 and one Coca Cola machine in the amount of $45.00, a total property value in the amount of $33,568.00. Under the listing of the Coca Cola machine, it is stated that "other equipment is property of U.S. Navy". By Act 300, Session Laws 1951, the legislature likewise

made an appropriation in the amount of $716.54 for this refund, conditioned however in the manner above stated (see Item 1 supra).

The personal property tax having been repealed by Act 111 of the Session Laws of 1947, only this refund claim is involved.

(9) A claim for refund of gross income taxes for the years 1946, 1947, and 1948, in the following amounts:

1946 - - - - - - - - - - $5,522.65

1947 - - - - - - - - - - - 12,343.38

1948 (to February) - - 1,827.90

These refunds were claimed by filing with the tax commissioner, on August 7, 1950, amended returns. Prior thereto, on April 7, 1948, the Commandant of the Fourteenth Naval District advised the tax commissioner that the refund of gross income taxes was claimed.

Collectability of further gross income taxes also is involved.

(4) Withholding of the 2% compensation and dividends tax from wages of employees of said Shipyard Restaurants. Prior to said letter of April 7, 1948, this tax had been withheld from employees' wages. By said letter of April 7, 1948, the Commandant advised the tax commissioner that the restaurant board operating the Shipyard Restaurants would discontinue this.

According to the facts furnished by the Shipyard Restaurants, prior to July 1, 1946 the food service for civilian employees at the navy yard was operated by concessionaires, and for a period immediately prior to July 1, 1946 through a manager employed by the Shipyard commander. On June 21, 1946, the Shipyard commander, acting under Navy Civilian Personnel Instructions 66, established a Restaurant Board consisting of six civilian employees or the shipyard, with the industrial relations officer of the shipyard as an ex-officio member representing the Shipyard commander. By this directive the Shipyard commander directed this board to negotiate for and enter into a contract of employment with a manager for the Shipyard Restaurant System, subject to the approval of the shipyard commander. The board was directed to be guided by the instructions contained in Navy Civilian Personnel Instructions 66, dated April 17, 1945, as amended. As below set forth, among these instructions was one directing that all taxes be paid.

Since July 1, 1946, the board has supervised the management and operation of cafeterias and several refreshment stands for civil service employees of the Pearl Harbor Naval Shipyard 1. No alcoholic beverages are sold. A loan to commence operation was made available from the Welfare Fund, and the navy furnishes the use of land, buildings and much of the equipment. A monthly inventory of foodstuffs is taken by an inventory board (non-restaurant board members) appointed by

the Shipyard commander. The Shipyard commander also appoints an audit committee of other civil service employees (non-restaurant board members). The restaurant is not authorized to make any sizeable expenditure, other than for purchase of consumable supplies, without the approval of the Shipyard commander.

Profits of the Shipyard Restaurants, over and above those used for improved food service, are used for the welfare of shipyard employees, in accordance with recommendations approved by the Shipyard commander.

The status of the Shipyard Restaurant System for the period commencing July 1, 1946, first was presented to the tax commissioner of the Territory in an application for exemption from gross income taxes. In this application the Shipyard Restaurants were described as a non-incorporated, non-profit organization operating at cost for the betterment of the community. No claim then was made that this association was a federal instrumentality. By a letter dated August 10, 1946, this office advised the tax commissioner that the association was a form of cooperative, and that there was no exemption in the general excise tax law of the Territory applicable to such a cooperative. By a letter dated September 6, 1946, the Shipyard Restaurants were so advised by the tax office. Thereafter territorial taxes were paid until, by the aforesaid letter of

April 7, 1948, the Commandant advised the tax commissioner that the restaurant board would cease payment of the general excise tax, net income tax, and personal property tax, and would cease collection of the 2% tax.

The Bureau of Internal Revenue, by a letter dated June 26, 1947 (I T:P:ER:WOB), advised the Shipyard Restaurants that "as now operated, you are an integral part of the Navy Department, deemed by it to be essential for the performance of governmental functions, and that as such, you may be considered to be an instrumentality of the United States for Federal income tax purposes". But by a letter dated July 25, 1947 (EmT:RR:2-LHW) the Bureau of Internal Revenue, upon consideration of the status of the Shipyard Restaurants for Federal employment tax purposes, ruled "that the Shipyard Restaurants are self-supporting activities established and operated by an employee's organization for the benefit and convenience of the civilian employees of the Shipyard". After calling attention to the fact that it did not appear from the regulations governing the operation of the restaurant services that the Navy Department was responsible for any liability incurred, this letter continued: "* *It is the opinion of this office that the employees' organization which operates the Shipyard Restaurants is, for Federal employment tax purposes, an entity separate and distinct from the naval establishment and the Navy Department, and that neither it nor the service is an instrumentality

wholly owned by the United States within the meaning of Sections 1426(b)(6) and 1607(c)(6) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively. It is believed that the supervision and authority exercised by the commander, Pearl Harbor Naval Shipyard, over the restaurant services are not so direct and extensive that the individuals who render services in connection with such activities can be regarded as employees of the United States Government".

After receipt of the two rulings of the Bureau of Internal Revenue a representative of the Shipyard Restaurants asked for clarification of the situation and the Collector of Internal Revenue referred the matter to the Bureau. In a letter dated June 3, 1948 (WET:N) the Collector of Internal Revenue advised the District Legal Office of the Navy "the Bureau has advised that an organization may be an instrumentality of the United States and not necessarily be an instrumentality 'wholly owned' by the United States. The Shipyard Restaurants is an instrumentality of the United States and as such is exempt from Federal income tax. However, the taxpayer is not an instrumentality 'wholly owned' by the United States and services performed in its employ are not excepted from employment under the provisions of Sections 1426(b)(6) and 1607(c)(6) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act respectively".

The Judge Advocate General of the Navy, as shown by a letter of July 26, 1948 to the Commandant of the Fourteenth Naval District (JAG:III:NC:lW) has not contested the position of the Bureau or Internal Revenue that the Shipyard Restaurants are not wholly owned by the United States, but relying on the Bureau of Internal Revenue ruling that the Shipyard Restaurant System nevertheless is a Federal instrumentality, has taken the position that there is no liability for territorial net income taxes and general excise taxes and that the 2% compensation and dividends tax should not be withheld from the wages of employees. This opinion makes no reference to the regulation, NCPI 66.

We cannot agree with the Bureau of Internal Revenue or the Judge Advocate General in so far as it has been stated that the Shipyard Restaurants, although not wholly owned by the United States, constitute an instrumentality of the United States. The holding or the Supreme Court of the United States that post exchanges partake of the immunities of the War Department under the Constitution and Federal statutes was based upon the conclusion that such post exchanges "are integral parts of the War Department". (Standard Oil Company v. Johnson 316 U.S. 48l, 485, decided June 1, 1942.) The Shipyard Restaurant System is not an integral part of the Navy department. It was organized on July 1, 1946, under NCPI 66 dated April 17, 1945, as amended; those regulations do not purport to establish any agency for

food services for civilian employees as an integral part of the Navy department or as any type of entity having federal instrumentality status.

The regulations offer two alternatives, that is, the employment of a concessionaire or management of the service by an employee organization, the latter being the alternative employed here. As to this type of operation it is provided:

> "Operation by employee organization. -- Where the employees and the Commanding Officer determine it would best serve the activity's interests to manage the service through an employee group, with the employment of an operating manager, it is recommended that the employees assuming the responsibilty (usually the 'Restaurant Board') organize a non-profit corporation to avoid any personal liability falling to any member of the group." (NCPI 66, Section 3-1 a(5), issue of April 17, 1945.)

The regulations further contain this clear provision as to liability for taxes:

> "Taxation. -- The restaurant service shall pay, as and when due, any and all taxes becoming due by virtue of the operation of such restaurant service, including, but not limited to, all real estate or other taxes which may be held to be properly imposed on its possessory interest in the right to use the government premises." (NCPI 66, Section 311 a(8), issue of April 17, 1945.)

In later issues of these regulations similar provisions are made. Thus, in the copy furnished with the legislative claim, the following appears:

> "Operation of Food Service.--a. Operation by employment of a manager. -- Where the decision of the Association as approved by the head of the activity, is

that it would best serve the activity's interests to employ an operating manager rather than the services of a concessionaire, an appropriate directive or station order with copy to OIR 235 will be issued, setting forth the conditions of operation, and giving the Cafeteria Association authority to use the facilities under the conditions prescribed in NCPI 66.4-4. It is suggested that in such a case the Cafeteria Association organize itself into a non-profit corporation in order to avoid personal liability for operations in connection with the food service." (NCPI 66, Section 4-3, issue of October 10, 1949.)

"Taxation. -- The food service shall pay, as and when due, any and all taxes becoming due by virtue of the operation of such food service, including, but not limited to, all real estate or other taxes which may be held to be properly imposed on its possessory interest in the right to use the government premises. When the association employs a manager, it is considered a non-profit cooperative for tax purposes." (NCPI 66, Section 4-4 b, issue of October 10, 1949.)

Hence it appears that the Shipyard Restaurant System is a non-profit cooperative with a possessory interest in government property made available for its use, that the employees concerned in the operation of this food service are personally liable for its obligations, that they may, if they desire, organize a corporation for their own protection against such personal liability, and that the decision as to organizing a corporation rests with them. Far different language has been employed when it was the desire of the Navy department to constitute an agency as an integral part of the Navy department or a wholly owned instrumentality.

As an organization separate and apart from the Navy department, this employees' cooperative is not a Federal instrumentality. By Section 304(a) of Public Law 248, 79th Congress,

1st Sessions, approved December 6, 1945 , 59 Stat. 602, (31 USC 869), Congress specifically provided:

> "Sec. 304. (a) No corporation shall be created, organized, or acquired hereafter by any officer or agency of the Federal Government or by any Government corporation for the purpose of acting as an agency or instrumentality of the United States, except by Act of Congress or pursuant to an Act of Congress specifically authorizing such action."

Thus the Navy cannot confer on this organization the status of a Federal instrumentality. Even though the organization remains an association that has not attained corporate status the Act of Congress applies, for any claim that it is a Federal instrumentality necessarily is based on the theory that it is an entity or quasi-corporation. Viewed as a group of Federal employees who are serving their own welfare these employees are no more entitled to tax exemption then were the employees involved in Graves v. O'Keefe, 306 U. S. 466, and State Tax Commission v. Van Cott 306 U. S. 511. Under the doctrine of those cases the salaries of Federal employees are taxable; additional benefits in the form of aid received by such employees in operating a cooperative food service are equally taxable. No property of the United States is being taxed but only the receipts derived from the loan of Federal property and from activities of private individuals operating in their own behalf under the supervision of the United States. See Buckstaff Co. v. McKinley, 308 U. S. 358; James v. Dravo Contracting Co.,

302 U. S. 134; Wilson v. Cook, 327 U. S. 474; Carnegie-Illinois Steel Corp. v. Alderson, 127 W. Va. 807, 34 S. E. 2d 737, cert. den. 326 U. S. 764; Kaiser Co. v. Reid, 30 Cal. 2d 610, 184 P 2d 879; 0klahoma Tax Commission v. Texas Co., 336 U. S. 342. These cases show how the field of implied governmental tax immunity has been narrowed. Only a specific Act at Congress could confer on the Shipyard Restaurants immunity from territorial taxes.

My conclusions as to the matters revolved are as follows:

(1) The amount of $2,106.97 claimed as a refund of net income taxes on income of the year 1946 is not refundable, since these taxes were collected in accordance with law. The Shipyard Restaurants further is liable to the territorial net income tax on income of the year 1947 to 1950, inclusive; it is an association taxable as a corporation. However, commencing with the year 1952 it is exempt from tax on income of the year 1951 by reason of the specific provision of Act 166 of the Session Laws of 1951 which exempts "local associations of employees, the membership of which is limited to the employees of a designated person or persons, and the net earnings of which are devoted exclusively be charitable, educational, or recreational purposes within the Territory of Hawaii". While this exemption refers to employees of a "person" and the employees who form this association are employees of the United

States, nevertheless the United States may be regarded as a person depending upon the intent of the statute involved, and the 1951 amendment should be viewed as applicable to associations of employees of the Federal Government the same as other employees.

(2) The amount of $716.54 claimed as a refund of personal property taxes for 1947 is not refundable, since these taxes were collected in accordance with law; the property taxed was not the property of the United States. No further personal property taxes are involved since this tax was repealed by Act 111 of the Session Laws of 1947.

(3) The gross income taxes paid for 1946, 1947, and a part of 1948, are not refundable by the tax commissioner; our further consideration of this matter leads to no change in our letter of August 10, 1946, which advised you that the Shipyard Restaurant System is not an organization operated for the benefit of the community; there is no specific exemption contained in the gross income tax law that applies. The legislature has made no change in the exemption from this tax. Gross income taxes also are payable for the balance of 1948 and for subsequent years.

(4) The 2% compensation and dividends tax is required to be withheld from the wages of employees of the Shipyard Restaurants System. Even Federal instrumentality status

would not relieve the association from this duty (Colorado National Bank v. Bedford, 310 U. S. 41, 53; of Wilmette Park District v. Campbell, 338 U. S. 411). To the extent that employees in the past have not paid the tax this association is liable for such delinquent taxes.

Very truly yours,

(s) Rhoda V. Lewis

Rhoda V. Lewis
Deputy Attorney General

APPROVED:

Walter D. Cathcart Jr.

Attorney General