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Constituional Law - Inter-Governmental Taxation - Immunity From State Sales Tax of Contractors Under "Cost-Plus-A-Fixed-Fee" Contracts With the United States

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he has expressed the view that it is for Congress, not the Court, to decide how far a state may go in regulating interstate commerce if such regulation is not discriminatory.[35] Has he relinquished this view by his asquiescence in this decision?

In conclusion, it is easy to formulate the proposition that a state tax on interstate commerce is valid if it is on a separable, local incident and invalid if on an inseparable, integral part of the commerce. The difficulty arises when this abstract proposition is applied to a concrete case, and one is called upon to decide whether the object of the tax in question is separable or inseparable, local or national in scope. Reasonable minds can well differ as to when the object becomes inseparable from, and a direct part of, interstate commerce, for in making that determination it is easy to point out distinctions where they apparently do not exist.

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CONSTITUTIONAL LAW—INTER-GOVERNMENTAL TAXATION—IMMUNITY FROM STATE SALES TAX OF CONTRACTORS UNDER "COST-PLUS-A-FIXED-FEE" CONTRACTS WITH THE UNITED STATES

Two tractors to be used in the construction of a government project were purchased by private contractors as "purchasing agents for the Government."[1] An Arkansas "gross receipts" tax[2] was levied on the sale and paid by the contractor's vendor under protest. The plaintiff vendor alleged that the tax was, in effect, a tax on the federal government and therefore invalid. The Arkansas Supreme Court upheld the tax.[3] On appeal to the

35. Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 452 (1939): "Congress is the only department of our government—state or federal—vested with authority to determine whether 'multiple taxation' is injurious to the national economy. . . ."

Id. at 455: "I would return to the rule that—except for state acts designed to impose discriminatory burdens on interstate commerce because it *is* interstate—Congress alone must 'determine how far [interstate commerce] . . . shall be free and untrammelled, how far it shall be burdened by duties and imposts, and how far it shall be prohibited.' [Welton v. Missouri, 91 U.S. 275, 280 (1875).]"

1. Kern-Limerick, Inc. v. Scurlock, 74 Sup. Ct. 403, 409 (1954).

2. Ark. Gross Receipts Tax Act of 1941, ARK. STAT. §§ 84-1901, 84-1902(e), 84-1903, 84-1908 (1947).

3. Parker v. Kern-Limerick, Inc., 254 S.W.2d 454 (Ark. 1953). The Arkansas Supreme Court relied on Alabama v. King & Boozer, 314 U.S. 1 (1941), holding that the *legal incidence* of the tax fell on the private contractor. When the *incidence*, which refers to the specific person or agency

United States Supreme Court it was *held* that the contractor was acting as an agent for the government and was exempt from the tax. It was *held* further "that the purchaser under this contract was the United States,"[4] and that the tax was invalid because its legal incidence was on the government and not on the private contractor. *Kern-Limerick, Inc. v. Scurlock*, 74 Sup. Ct. 403 (1954).

The doctrine of strict inter-governmental tax immunity is traceable to the opinion of Chief Justice Marshall in *McCulloch v. Maryland*.[5] This immunity was originally extended to salaries of federal and state officials, exempting them from income taxes of both the state and national government.[6] This principle that "a tax on income is a tax on its source" was later reversed.[7]

The strict immunity doctrine was held to cover a municipality's purchase of police motorcycles,[8] a veterans hospital's purchase of gasoline on which was levied a state sales tax,[9] and the storage and withdrawal of government-owned gasoline.[10] The most notable exception, or "loophole," made by the Court was the sanctioning of a West Virginia gross receipts tax on a private contractor under employ of the government. Here, the Court declared that a non-discriminatory tax, not placed directly on a governmental agency, was valid.[11]

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taxed, falls on a private contractor in a "cost-plus-a-fixed-fee" contract, the tax is valid even though the *economic burden* is ultimately borne by the government, said the Court.

4. 74 Sup. Ct. 403, 410 (1954).

5. 4 Wheat. 316 (U.S. 1819). There the Court held that Congress' power to create a national bank implied the power to preserve it, and the state tax on the bank was held invalid as an encroachment of the sovereignty of the United States.

6. Collector v. Day, 11 Wall. 113 (U.S. 1870), held invalid a federal income tax on the salary of a state judge; New York *ex rel.* Rogers v. Graves, 299 U.S. 401 (1937), in which the salary of a railroad official employed by the government was held exempt from state income tax.

7. Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939) overruled the *Day* case, cited note 6 *supra*, and made ineffective other strict immunity cases.

8. Indian Motorcycle Co. v. United States, 283 U.S. 570 (1931).

9. Panhandle Oil Co. v. Mississippi, 277 U.S. 218 (1928). This case was limited and questioned by James v. Dravo Contracting Co., 302 U.S. 134 (1937), and Alabama v. King & Boozer, 314 U.S. 1 (1941), respectively.

10. Graves v. Texas Co., 298 U.S. 393 (1936). This case was limited and questioned by the *James* and *King & Boozer* cases, note 9 *supra*.

11. James v. Dravo Contracting Co., 302 U.S. 134 (1937). *Cf.* Oklahoma Tax Commission v. Texas Co., 336 U.S. 342 (1949), in which the Court held that non-Indian lessees on Indian reservations are not immune to state tax on gross production of oil. This case affirms Helvering v. Producers' Corp., 303 U.S. 376, 387 (1938), which overruled Gillespie v. Oklahoma, 257 U.S. 501 (1922).

The *James v. Dravo Contracting Co.*[12] decision was the starting point of the "transition period" of tax immunities; the Court had begun to lift the taxing ban on the states in regard to private contractors employed by the government. The peak of this transition was reached, in 1941, in *Alabama v. King & Boozer.*[13] Here the Court held that the state sales tax was valid despite the fact that the *economic burden* was on the government[14] because the purchasers were private contractors, and the *legal incidence* of the tax fell on them and not on the United States. "[The contractors] were not relieved of the liability to pay the tax either because the contractors, in a loose and general sense, were acting for the Government in purchasing the lumber or, as the Alabama Supreme Court seems to have thought, because the economic burden of the tax imposed upon the purchaser would be shifted to the Government by reason of its contract to reimburse the contractors."[15] The Court has consistently prohibited the assessment of taxes directly on governmental agencies,[16] but has recently allowed a tax on the storage of government-owned gasoline in Tennessee.[17]

It has been the Court's recent tendency to uphold taxes on private "cost-plus" contractors even though the *economic burden* has been borne by the government, if Congress has failed to exercise its right to grant express immunities.[18] The government's self-assumed burden has been met by a "hands-off"

12. 302 U.S. 134 (1937). See note 11 *supra.*

13. 314 U.S. 1 (1941).

14. The Court was satisfied to look only to see where the *legal incidence* of the tax fell. In the "cost-plus" contracts, the tax is added to the contract price so that the employer (the government in this case) actually bears the burden of the tax.

15. Alabama v. King & Boozer, 314 U.S. 1, 12 (1941). The *King & Boozer* case questioned Panhandle Oil Co. v. Mississippi, 277 U.S. 218 (1928) and Graves v. Texas Co., 298 U.S. 393 (1936).

16. *Cf.* Mayo v. United States, 319 U.S. 441, 447 (1943), holding invalid a state fee upon a federal government agency's inspection of fertilizer: "These inspection fees are laid *directly* upon the United States." (Italics supplied.)

17. Esso Standard Oil Co. v. Evans, 345 U.S. 495 (1953). This case distinguishes and strictly limits the case of United States v. County of Allegheny, 322 U.S. 174 (1944), where a property tax was held invalid as applied to government-owned machinery under lease to the "taxpayer" because the property was a measure of the tax. In the *Esso* case the tax was upheld because it was levied solely on the privilege of storing.

18. See Carson v. Roane-Anderson Co., 342 U.S. 232 (1952), wherein the Tennessee sales and use taxes were held invalid as applied to government contractors working on an atomic project. The Atomic Energy Act of 1946 [60 STAT. 765 (1946), 42 U.S.C. § 1809(b) (1946)] expressly exempted such contractors' purchases from state taxation, and provided for lump sum payments to the states in lieu of the taxes.

policy[19] on the part of the Court, and its effect has been to prevent impairment of the states' taxing power.[20]

The majority opinion distinguished the *King & Boozer* case which was held not controlling since in that case, though the government also bore the *economic burden*, the *legal incidence* of the tax involved was held to fall on the independent contractor.[21] In the present case the *legal incidence* of the tax is on the government since a Navy purchase order was used, making the government the purchaser. In effect, however, the contractor was granted this immunity in the present case because the Court desired to relieve the government of the *economic burden*, a factor that has been ignored by the Court for many years. Undoubtedly this new immunity doctrine will meet with no small amount of criticism, especially among the states where large government projects are under construction.

In the instant case, the dissenting opinion[22] questioned the power of a government agency to re-delegate government spending to a private contractor without authorization by Congress. It maintained that the United States was not the purchaser of the tractors within the meaning of the Arkansas statute[23] and could not render the contractor immune from the tax.[24] The dissenters felt that the *King & Boozer* decision could not be distinguished, and therefore should be followed.[25]

It seems that the Court, as a matter of policy, is altering the

19. Court usually found the tax valid unless it fell directly on the governmental agency (see note 14 *supra*), or had been expressly rendered inapplicable to certain government employees (see note 18 *supra*).

20. See Esso Standard Oil Co. v. Evans, 345 U.S. 495 (1953), 102 U. OF PA. L. REV. 241.

21. 74 Sup. Ct. 403, 411 (1954). The *King & Boozer* decision was further distinguished in that the Court held in that case that the contractor was not an *agent* of the government. *Id.* at 409. In the present case, it was held that the contractor was the government's *agent* and thus was exempt from state taxation.

22. 74 Sup. Ct. 403, 412 (1954) (Douglas, J., with whom Warren, C.J., and Black, J., joined.

23. "No doubt the United States was, under some of the language used in *King & Boozer*, the 'purchaser' of these two tractors. But the United States is not the 'purchaser' under the language used in the Arkansas statute, and it is the Arkansas statute that controls this case." *Id.* at 413.

24. The dissent held that the legal incidence of the tax fell on the private contractor despite the contract between the latter and the government which allegedly makes the contractor an *agent* for the government.

25. "State of Alabama v. King & Boozer and the cases it followed [James v. Dravo Contracting Co., 302 U.S. 134 (1937) and Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939)] were a long step forward from the time when a State's power to tax was nullified whenever the federal treasury was even remotely affected. We should not take this equally long step backwards." 74 Sup. Ct. 403, 413 (1954).

decade-old trend of allowing the states to levy sales taxes indirectly on the government, through private contractors, when such action has not been expressly prohibited by congressional action.[26] The implication of the instant decision is that the Court will examine state taxes to determine where the *economic burden* ultimately lies. The *legal incidence* fiction seems to have been in effect abandoned, at least for the present time. The dissenting opinion refers to the majority opinion as a "long step backwards,"[27] but there is no definite indication that the Court has re-established a variation of the old strict immunity doctrine.

The present decision does place a certain limitation upon state taxation of private individuals' purchases when made for use in fulfilling government contracts. Thereby, it is possible for the government to deprive the states of substantial revenues by employing private contractors as purchasing agents and imparting to them the government's immunity from state taxation. In the event there is too great a burden imposed on the states by this latter practice, the Court might well offer a remedy by reverting to the *legal incidence* principle.

It is submitted that this decision is questionable since it insufficiently distinguished the *King & Boozer* case. Even if the majority opinion were justified in distinguishing this case, it is evident that the Court has imposed a substantial limitation on the states' taxing power by granting immunity from state taxation to private contractors acting as purchasing agents of the government.

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CONTRACTS—IMPLIED ASSIGNMENT—ARTICLE 2011, LOUISIANA CIVIL CODE OF 1870

The purchaser of a home from a subdivision developer brought action against the contractor's surety, alleging noncompletion of the building contract and defective work. His action was based on the combined recordation of the contract and surety bond between the vendor and the contractor. The district court found no privity of contract between the purchaser

26. Congress may grant express immunity to private contractors in its employ. See note 18 *supra*.

27. See note 25 *supra*.