EXPRESS OR IMPLIED EXCLUSIONS FROM CONSUMPTION EXCISES—TYPES OF CONSUMERS

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Exemptions from consumer excises,[1] based on the type of consumer purchasing or using the taxed goods or services, may conveniently be divided into two categories, those based on constitutional grounds and those granted by the legislature pursuant to some policy of its own. The former class involves chiefly those exemptions grounded in implied governmental immunities while the latter varies much from state to state with two exceptions, one the consequence of federal requirement and the other of a tax principle uniformly accepted in the states. State legislative freedom in classification has come about only by judicial declination of the contention that sales and use exactions have the constitutional status of property taxes. For under a number of state constitutions exemptions as well as rates in property taxation must be uniform among all classes of persons or property; if, therefore, consumer taxes were held to be subject to this requirement there would exist little leeway for a legislative exemption policy. However, sales taxes have in a number of cases been construed to be true excises[2] and the legislatures thus accorded wide

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[1] The term is used to denote general and selective sales and use taxes.

[2] *Motor fuel,* which as the earliest commodity subject to sales taxation, has naturally borne the brunt of legal attack: Bowman v. Continental Oil Co., 256 U. S. 642 (1921); State v. City of Montgomery, 228 Ala. 93, 151 So. 856 (1933); People v. City and County of Denver, 84 Colo. 576, 272 Pac. 629 (1928); Sheip and Co. v. Amos, 100 Fla. 863, 130 So. 699 (1930); Breese Lumber Co. v. Mirabal, 34 N. M. 643, 287 Pac. 699 (1930), *aff'd,* 283 U. S. 788 (1931); Stedman v. Winston-Salem, 204 N. C. 203, 167 S. E. 813 (1933); State v. Brown, 112 Ohio St. 590, 148 N. E. 95 (1925); Foster and Creighton Co. v. Graham, 154 Tenn. 412, 285 S. W. 570 (1926); State v. Hart, 125 Wash. 520, 217 Pac. 45 (1923). In Amos v. Mathews, 99 Fla. 1, 126 So. 308 (1930), it was held that the second and third gasoline taxes (really additions to the basic tax) were on the privilege of selling gasoline and not for the privilege of road use. The gasoline tax has also been upheld against the claim that as a road user tax it violates the "no toll" provisions of the Federal Post Roads Act and the Federal Highway Act. Cunningham v. Potts, 9 F. (2d) 469 (W. D. Wash. 1925); Anthony v. Kozer, 11 F. (2d) 641 (D. Ore. 1926), appeals dismissed on jurisdictional grounds, 273 U. S. 651 (1927). *Sales:* Frazier v. Tax Comm., 234 Ala. 353, 175 So. 402 (1937); Wiseman v. Phillips, 191 Ark. 63, 84 S. W. (2d) 91 (1935); Leonard v. Maxwell, 216 N. C. 89, 3 S. E. (2d) 316 (1939); Fox v. Frank, 52 Ohio App. 483, 198 N. E. 873 (1935); Assessment of Knapp, 185 Okla. 584, 95 P. (2d) 92 (1939); Sioux Falls Motor Co. v. Welch, 65 S. D. 68, 270 N. W. 852 (1936). The first Illinois sales tax was construed as a property tax and held unconstitutional because it exempted sales on farm products and

discretion in the matter of classifying users and uses of property subject to tax.[3] The compensating use tax, apparently much more vulnerable to the charge that it is a property tax, has also been sustained as an excise on one attribute of property, its use.[4] The exemptions that are the product of this legislative discretion are first considered.

GASOLINE USER EXEMPTIONS

Only under the motor fuel tax is an exemption or refund privilege granted to any considerable class of users. Twenty-three states and the District of Columbia relieve from tax all non-highway use of gasoline, either by exempting the sale in the first instance or by refunding the amount of tax.[5] Eight other states, while adhering in general to the road toll principle, do not relieve non-highway use of all tax. These eight are Idaho, Michigan, Oregon and Virginia, which impose a low-rate tax on aircraft gasoline, South Dakota where the regular rate is payable on aircraft gasoline, Maine and Mississippi where the refund granted is one cent less than the rate of tax, and North Carolina where refunds are limited to five cents per gallon except in the case of aircraft gasoline.[6] Seven states—Nebraska, New Jersey, North Dakota, Oklahoma, Tennessee, West Virginia and Wyoming—exempt or refund the

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gasoline. Winter v. Barrett, 352 Ill. 441, 186 N. E. 113 (1933). A second act, in form a tax on the privilege of selling tangible personal property at retail, was sustained. Reif v. Barrett, 355 Ill. 104, 188 N. E. 113 (1933). *Tobacco:* Mississippi State Tax Comm. v. Flora Drug Co., 167 Miss. 1, 148 So. 373 (1933); Havens v. Attorney General, 14 A. (2d) 636 (N. H. 1940); Stephano Bros. v. Hamilton, Ct. Com. Pleas. Dauphin County, Pa., 1940 (unreported).

Federal excises are indirect taxes and subject only to the requirement that they be geographically uniform. U. S. CONST. Art. I, §8, cl. 1; Hylton v. United States, 3 Dall. 171 (U. S. 1796); Nichol v. Ames, 173 U. S. 509 (1899); Knowlton v. Moore, 178 U. S. 41 (1900); Bromley v. McCaughn, 280 U. S. 124 (1929). Any doubt remaining after *Knowlton v. Moore* and *Brownley v. McCaughn,* that a federal general sales tax would be unconstitutional as a direct tax, should be dissipated by the view the Court has taken of state use taxes. See note 4, *infra.*

[3] Frazier v. Tax Comm., *supra* note 2; Montgomery Ward & Co. v. Fry, 277 Mich. 260, 269 N. W. 166 (1936); Southern Package Corp. v. Tax Comm., 174 Miss. 212, 164 So. 45 (1935); Notgrass Drug Co. v. State *ex rel.* Rice, 175 Miss. 358, 165 So. 884 (1936); Assessment of Knapp, *supra* note 2. See also Washington v. Inland Empire Refineries, 3 Wash. (2d) 651, 101 P. (2d) 975, *cert. denied,* 311 U. S. 713 (1940); and compare Morrow v. Henneford, 182 Wash. 625, 47 P. (2d) 1016 (1935).

[4] Henneford v. Silas Mason Co., 300 U. S. 577 (1937); Vancouver Oil Co. v. Henneford, 183 Wash. 317, 49 P. (2d) 14 (1935); City of Spokane v. Washington, 198 Wash. 682, 89 P. (2d) 826 (1939).

[5] ARIZ. CODE ANN. (1940) §66-319; CAL. GEN. LAWS (Deering, Supp. 1939) act 2964, §11; COLO. STAT. ANN. (Michie, 1935) c. 16, §384(c); CONN. GEN. STAT. (Supp. 1935) §656c; DEL. REV. CODE (1935) §222(b); ILL. STAT. ANN. (Jones, 1935) §85.124; IND. STAT. ANN. (Baldwin, 1934) §16033(a); IOWA CODE (Reichmann, 1939) §5093.29; KAN. REV. STAT. (Corrick, Supp. 1939) §79-3010; MD. ANN. CODE (Flack, 1939) art. 56, §255; MASS. ANN. LAWS (1933) c. 64A, §7; MINN. STAT. (Mason, Supp. 1940) §2720-71; MO. REV. STAT. ANN. (1929) §7805; MONT. REV. CODE ANN. (1935) §2396.4; NEV. COMP. LAWS (Hillyer, Supp. 1938) §6570.05; N. H. LAWS (1926) c. 104, §7, as amended by N. H. Laws 1935, H. B. No. 88; N. M. STAT. ANN. (Courtwright, Supp. 1938) §60-301; N. Y. TAX LAWS §289-c; OHIO GEN. CODE ANN. (Page, 1937) §5527(a); R. I. GEN. LAWS ANN. (1938) c. 45, §5; TEX. STAT. (Vernon, 1936) art. 7065a-13; W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §995(20); WIS. STAT. (1939) §78.02(2).

[6] Idaho Laws 1937, c. 57; Me. Laws 1937, c. 175, §80; MICH. COMP. LAWS (Mason, Supp. 1940) §3603-2; MISS. CODE ANN. (Supp. 1938) §1222(b); N. C. CODE ANN. (Michie, 1939) §2613(115); ORE. COMP. LAWS ANN. (1940) §101-1711 (differential tax on aircraft); S. D. CODE (1939) §57-3812; Va. Laws 1938, c. 368, as amended by Va. Laws 1940, c. 7.

tax on gasoline used for specified purposes.[7] In three of these states, New Jersey, North Dakota and West Virginia, refundable uses are comprehensive, embracing practically all non-highway uses. All gasoline is taxable in Arkansas and Florida with the exception of that used for aircraft, and, in Utah, all save that manufactured, used or sold within the state from local coal, oil shales, asphalts and solid hydrocarbons.[8] Alabama, Georgia, Kentucky, Louisiana, Pennsylvania, South Carolina and Vermont tax all gasoline except that which they are prohibited from taxing under constitutional limitations.[9]

Types and Amounts of Non-Highway Uses

The principal uses of tax-free motor fuel vary from state to state. In agricultural regions the operation of farm machinery such as tractors and stationary engines accounts for the greater part. In other sections of the country industrial uses predominate. Solvents classifiable as motor fuel are used in cleaning and dyeing work. Other non-highway uses include contracting and construction, governmental, railroad, marine and power generation.[10]

According to the latest information available about 92 per cent of all motor fuel consumed in 1939 was used on the highways. About nine per cent of the total amount of gasoline consumed was not taxed. The discrepancy between these two figures is caused in part by governmental use. About three per cent of all motor fuel was used by the federal, state and local governments and over 80 per cent of this amount was used on the highways.[11] Much of the gasoline used by local governments on the highways is taxed, for a number of the states do not exempt their political subdivisions.[12]

Limitations on Refunds and Exemptions

Even in those states where general non-highway use of gasoline is exempt from tax or a refund may be secured, the privilege does not apply to all gasoline so used. Motor fuel delivered into a vehicle tank and subsequently used for propelling the vehicle both on the public highways and on private property is not eligible for refund.[13] The usual requirement is that the motor fuel intended for non-highway

[7] Neb. Laws 1941, B. 470; N. J. STAT. ANN. (perm. ed.) tit. 54, §§39-65, 39-66; N. D. Laws 1937, c. 248, §2; Okla. Laws 1939, c. 66, art. 14, §§7-8; TENN. CODE ANN. (Williams, Supp. 1938) §1128.1; W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §995(20); Wyo. Laws 1941, c. 48, §4, amending WYO. REV. STAT. (Supp. 1940) c. 115, art. 11.

[8] ARK. DIG. STAT. (Pope, 1937) §66046; FLA. COMP. GEN. LAWS (Skillman, Supp. 1940) §1167(102); UTAH REV. STAT. ANN. (1933) §57-12-5.

[9] Ala. Acts 1935, H. B. No. 324, art. xiii, c. 4, sch. 156.1; Ga. Laws 1937, No. 191; KY. STAT. ANN. (Carroll, 1936) §§4281g-1, 4281h-1 (cleaner solvent exempt); LA. GEN. STAT. ANN. (Dart, 1939) §§8806, 8826 (cleaner solvent exempt by judicial construction); PA. STAT. ANN. (Purdon, Supp. 1940) §§2611b, 2611d; S. C. CODE (1932) c. 107, art. 3; VT. PUB. LAWS (1933) c. 52.

[10] Fed. Tax Adm'rs, *Administration of Gasoline Tax Refunds and Exemptions* (1940), and *Exempt and Refundable Uses of Gasoline* (1940); CRAWFORD, MOTOR FUEL TAXATION IN THE UNITED STATES (1939) c. 5.

[11] Federal Works Agency, Public Roads Administration, *Analysis of Motor Fuel Usage* (1939) Table G-21, and *Motor Fuel Consumption* (1939) Table G-2.

[12] State treatment of gasoline used by local subdivisions is discussed *infra*.

[13] Brady v. Long, 285 Mass. 379, 189 N. E. 83 (1934).

use be separately bought and invoiced. In Washington no refund is allowed for motor fuel used in vehicles that are capable of being operated on the public highways.[14] However, if the motor vehicle in which the fuel is used is of such a type that it is not eligible to be licensed for operation on the highways, a refund of tax may be obtained.[15]

The reason for these limitations lies in the difficulty of ascertaining the amount of motor fuel used for non-highway purposes. Because the administrator of the tax has no way of checking the accuracy of the user's estimates of highway and non-highway use, an unlimited refunding system would be open to many abuses. If complete operation records were regularly kept so that an accurate segregation of highway and non-highway use was possible a different result might follow.

An extremely liberal construction in favor of agricultural users of motor fuels has been made by the Oklahoma supreme court.[16] There the statute provides that a permit may be secured to purchase gasoline tax free for agricultural purposes. The application for a permit must show the legal description of the agricultural land owned, leased or rented. On the basis of this provision, the Tax Commission ruled that a permit holder could not buy tax-exempt motor fuel for use in work he was doing on land farmed by another. The commission regarded such a use as commercial rather than agricultural. The court, however, held that such a use was permissible, saying that the statutory test of exemption was whether the gasoline was used for agricultural purposes.

Basis for Non-Highway Use Exemption

The tendency to exempt non-highway uses from motor fuel taxation is quite understandable in view of the common acceptance of this type of tax as one paid on the basis of benefits received for road use. It has been contended, particularly in recent years, that a tax founded on the theory of direct benefit is of doubtful desirability. Not only may social considerations call for the extension of benefits to taxpayer groups relatively unable to pay for them; it is pointed out as well that it is quite difficult in most instances to evaluate the benefits received by various classes of taxpayers. This difficulty, however, is not so marked in connection with the gasoline tax as it is with respect to other types of benefit taxation. There is rather common agreement that at least a tolerable correlation of benefit and payment is possible in the case of the former. The consumption of gasoline and, therefore, the amount of tax paid varies approximately with the size and weight of the vehicle and the speed with which it is operated. Highway wear and tear also varies with the size, weight and speed of the vehicle. On the other hand, it has been pointed out that the correlation between consumption of gasoline and wear and tear on the roads is low for vehicles of different weights and it should also be noted that while the correlation between benefits and payments may be high for all motor-

[14] Elliott & Co. v. State, 191 Wash. 385, 71 P. (2d) 168 (1937).
[15] Mason-Walsh-Atkinson-Kier Co. v. Case, 2 Wash. (2d) 33, 97 P. (2d) 165 (1939).
[16] Protest of Hyde, 110 P. (2d) 292 (Okla. 1941).

ists as a group, there may be great discrepancies among individual motorists in the matter of taxes paid and benefits received. Such discrepancies depend on a number of factors, among them the manner in which the vehicle is used and the locality in which it is operated, whether on rural roads, state trunk highways, or city streets.[17]

But despite these and other technical difficulties involved,[18] it is an undeniable fact that the gasoline tax is commonly accepted as a road user charge. Indeed, two high-yield exactions, the social security and gasoline taxes, are predicated upon the benefit principle. Together, unemployment compensation and gasoline taxes accounted for over 40 per cent of all state tax collections in 1940.[19] More than exemptions for non-highway use flow from the theory and accepted basis of gasoline taxation; there is, correspondingly, much pressure to apply the total proceeds of this tax to highway purposes. Prior to 1931 over 99 per cent of state gasoline tax collections were devoted to highway construction and maintenance and the servicing of highway debt. But with the coming of the depression state legislatures turned to the gasoline tax to raise money for other than highway purposes. In 1932 non-highway functions received about nine per cent of total gasoline tax revenues; in 1939 the percentage was sixteen and one-half.[20] Diversion of such a significant percentage of these revenues has resulted in a movement to restrict the expenditure of motor fuel tax collections to the highways. The nature and effect of this movement, including the devices employed to achieve the end desired, are reviewed in an earlier portion of this symposium.[21]

OTHER LEGISLATIVE CONSUMER EXEMPTIONS

No class of individuals as consumers, comparable to non-highway users of gasoline, are legislatively exempted from other state sales or use taxes, including those on tobacco and liquor.[22] Under the general sales tax, sales to the state and its political subdivisions and to charitable and non-profit institutions are the more common instances where entities as such are exempt from tax. The nearest approach

[17] See GROVES, FINANCING GOVERNMENT (1939) 354; SHULTZ, AMERICAN PUBLIC FINANCE (2d rev. ed. 1938) 540-541; BUEHLER, PUBLIC FINANCE (2d. ed. 1940) 646-652.

[18] If the benefit theory is to be strictly applied to gasoline and motor vehicle taxation, further questions are presented. On what basis should costs and benefits be allocated among different users? What governmental units should maintain which streets? Should road users pay all highway costs? What proportion of real property or other local taxes should be devoted to city streets? For studies dealing with these problems, see PUBLIC AIDS TO TRANSPORTATION (1940), a report of the Federal Coordinator of Transportation; MOULTON, THE AMERICAN TRANSPORTATION PROBLEM (1933); BREED, HIGHWAY COSTS (1939), a report to the Association of American Railroads; STOCKER, IS MOTOR TRANSPORTATION SUBSIDIZED; REPORT OF THE ROYAL COMMISSION ON TRANSPORTATION (Ontario, 1938).

[19] U. S. BUREAU OF THE CENSUS, STATE TAX COLLECTIONS (1940) Sp. Study No. 10.

[20] Federal Works Agency, Public Roads Administration, *Disposition of Motor Fuel Tax Receipts* (1938-1939) Table G-3; CRAWFORD, *op. cit. supra* note 10, c. 7. The Public Roads Administration publishes yearly, on the basis of information from official state agencies, a number of thorough analyses of data on motor fuel tax and motor vehicle license fee collections and expenditures.

[21] See Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes, supra* this issue.

[22] Various digests which include exemption provisions are available. See Am. Retail Fed., *State Sales Tax Laws* (1940); C. C. H., *Interstate Sales Taxes* (1940); Fed. Tax Adm'rs, *Digest of State Sales Tax Laws* (1940); TAX SYSTEMS OF THE WORLD (8th ed. 1940).

to an exemption of a class of individual consumers is found in those states which exclude sales of feed, seeds, and fertilizer. Although in statutory terms this is an exemption by type of commodity,[23] rather than by type of consumer, in essence it is of the latter type inasmuch as these articles constitute a goodly proportion of a farmer's purchases. One available ruling on the purpose of the exemptions on goods sold to farmers indicates a policy of fostering the business of farming. Sales of goods to farmers or dairymen are exempt if the articles sold are for the production of crops intended for marketing, but taxable if the purpose of the production is ultimate consumption by the grower himself.[24]

No matter what type of general sales tax is in force in a particular state, whether a tax on the privilege of buying or selling, or an excise on the sale itself, the practical effect of the tax does not vary from state to state. The administrator looks to the retailer as the responsible taxpayer, and the retailer adds the tax to the consumer's bill.[25] Since the consumer foots the bill some of the many and varied exemptions by type of commodity which are found in state sales tax statutes may be in reality limited exemptions to a particular type of consumer.

Although in Missouri a division of the state government has been held liable for state sales taxes on materials it purchases,[26] it is almost universal practice specifically to exempt from tax sales to a state's own departments.[27] Also undictated by constitutional necessity are the provisions quite commonly found exempting municipalities from payment of general and selective sales taxes on purchases of material, except gasoline, to be used for public purposes. These express provisions have seemingly given rise to no serious questions of construction. This is not true, however, of municipal and county efforts to spell such exemptions out of constitutional or statutory exemptions of local governments from all *ad valorem* taxes. These efforts have nevertheless generally met with failure before the state courts,[28] even the but-

[23] Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes, supra* this issue, treat exemptions of such character.

[24] Farm Bureau Services, Inc. v. Board of Tax Admn., Circ. Ct. Ingham County, Mich., 1934 (unreported).

[25] The distinction between the statutory incidence and the economic incidence of various sales taxes has caused the courts some trouble. Compare, *e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 308 U. S. 546 (1940), and Colorado National Bank v. Bedford, 310 U. S. 41 (1940), with *In re* Conklin, 110 F. (2d) 178 (C. C. A. 2d, 1940), and *In re* Newland, 115 F. (2d) 165 (C. C. A. 3d, 1940). See also Arkansas Power and Light Co. v. Roth, 103 Ark. 1015, 104 S. W. (2d) 207 (1937); Tanner v. State, 238 Ala. 265, 190 So. 292 (1939); Rush v. Brown, 187 Okla. 97, 101 P. (2d) 262 (1940). Consult further, Martin, *Distribution of the Consumption Tax Load, supra* this issue.

[26] State *ex rel.* Missouri Portland Cement Co. v. Smith, 338 Mo. 409, 90 S. W. (2d) 405 (1936).

[27] See the digests cited in note 22, *supra*.

[28] Birmingham v. State *ex rel.* Carmichael, 233 Ala. 138, 170 So. 64 (1936); Long v. Roberts and Son, 234 Ala. 570, 176 So. 213 (1937); State *ex rel.* Carmichael v. Board of Education, 237 Ala. 434, 187 So. 414 (1939); County Board of Education v. Alabama, 239 Ala. 276, 194 So. 881 (1940) (liable for penalties and interest also); McCarroll v. Mitchell, 198 Ark. 435, 129 S. W. (2d) 611 (1939); People v. City and County of Denver, 90 Colo. 598, 10 P. (2d) 1106 (1932); Wright v. Fulton County, 169 Ga. 354, 150 S. E. 262 (1929); Independent School District v. Pfost, 51 Idaho 240, 4 P. (2d) 893 (1931); People v. Deep Rock Oil Co., 343 Ill. 388, 175 N. E. 572 (1931); State v. Des Moines, 221 Iowa 642, 266 N. W. 41 (1936); City of Lawrence v. French, 31 Kan. 447, 18 P. (2d) 570 (1933); Covington v. State Tax Comm., 257 Ky. 84, 77 S. W. (2d) 386 (1934); State v. City of Monroe, 177 La. 983, 149 So. 541 (1933); Ardmore v. Oklahoma, 168 Okla. 316, 32 P. (2d) 728 (1934);

tress of home rule proving insufficient to give a municipality any preferred status so far as state excises are concerned.[29] Municipal resort to tax avoidance through the device of out-of-state purchase of gasoline has been successfully countered by state recourse to use taxation.[30] It is not uncommon to find the proceeds of a state's consumption excises shared with its political subdivisions. The practice is increasing and while there is no good reason for requiring those subdivisions to pay taxes on their purchases, they do in a number of cases receive this money back, although its use is frequently limited to specified objects.[31]

In connection with the other chief class of general consumer exemptions, sales to charitable and non-profit institutions, there is some diversity of opinion. If the consumer claiming the exemption is not a charitable and non-profit organization, the exemption has been held not to apply even though the profits of the organization are used to maintain an asylum which is purely a charitable institution.[32] The opposite view is not, however, without support.[33] Still another view holds that a charitable institution is liable for use taxes if it competes with a private business and derives income in excess of its expenses, without regard for the use to which this excess is put.[34]

DIPLOMATIC AND CONSULAR IMMUNITY

The second broad category of exemptions from excise taxes consists, it will be recalled, of those which derive from constitutional sources. So far as the states are concerned, exemption of diplomats by international usage and of consular officials by treaty action,[35] is of this character. Viewed from the federal standpoint, on the other hand, it is in each instance clearly the product of legislative and executive judgment rested upon the supremacy clause. This exemption thus partakes of both legislative and constitutional basis. While the federal government undoubtedly has the power to require the states and their subdivisions to respect exemptions granted

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Portland v. Kozer, 108 Ore. 375, 217 Pac. 833 (1923); Greenville v. Query, 166 S. C. 281, 164 S. E. 844 (1931), *aff'd,* 286 U. S. 472 (1932); Crockett v. Salt Lake County, 72 Utah 337, 270 Pac. 142 (1928). *Contra:* Commonwealth v. Pure Oil Co., 303 Pa. 112, 154 Atl. 307 (1931), but now changed by statute. See also O'Berry v. Mecklenburg County, 198 N. C. 357, 151 S. E. 880 (1930).

[29] Lubbock v. Magnolia Petroleum Co., 291 S. W. 660 (Tex. Civ. App. 1927).

[30] Greenville v. Query, *supra* note 28; Texas v. El Paso, 135 Tex. 359, 143 S. W. (2d) 366 (1940). In further implementation of the power to tax local subdivisions it has been held that a state may levy on a city's property in order to force payment of tax. Greenville v. Query, 172 S. C. 133, 173 S. E. 292 (1934).

[31] Smart and Hart, *supra* note 21, discuss allocation of state-collected consumption taxes to local subdivisions.

[32] German Masonic Temple Ass'n v. City, 279 N. Y. 452, 18 N. E. (2d) 657 (1939), *rev'g* 253 App. Div. 680, 3 N. Y. S. (2d) 596 (1938).

[33] Bedford v. Colorado Fuel and Iron Corp., 102 Colo. 538, 81 P. (2d) 752 (1938). See also Sailors' Snug Harbor v. McGoldrick, 255 App. Div. 64, 5 N. Y. S. (2d) 322 (1938), *aff'd,* 280 N. Y. 537, 20 N. E. (2d) 7 (1939).

[34] Oklahoma Tax Comm. v. Sisters of the Sorrowful Mother, 186 Okla. 339, 97 P. (2d) 888 (1939).

[35] Unlike diplomats, consular officials do not *per se* by reason of international usage enjoy exemption from taxation by the nation to which they are accredited. By a number of treaties, however, the United States has exempted these officials from all taxes, national, state and municipal, which are levied on their persons and, with some exceptions, on their property.

by treaty,[36] a number of questions have arisen as to the meaning and breadth of the exception. The application of general sales and selective gasoline taxes has given the most trouble, with a consequent lack of uniformity in the state administrative rulings on the point. For example, Illinois, Louisiana, New York and North Carolina allow the exemption in the case of the gasoline tax. New York requires the payment of the motor vehicle license fee; Maryland does not. Colorado and Washington exempt from the payment of sales tax, while California does not. In general, if a line is to be drawn, perhaps the statutory incidence of the tax furnishes the most certain one.[37]

USES BY INSTRUMENTALITIES OF INTERSTATE COMMERCE

The much-litigated commerce clause bears witness that the beneficiaries of those exclusions which derive purely from constitutional sources may be private individuals or groups as well as governmental agencies or departments. Within the ambit of consumption excises, the use tax is the case in point. Although this tax has become more widely known through its adoption to implement the general sales taxes by equalizing the condition of competition between local merchants and out-of-state sellers, thus lessening avoidance of tax through out-of-state purchases by consumers, it had already been utilized for similar purposes under gasoline taxation. Either by express enactment of a use tax or by including the first user of gasoline in the statutory definition of a "distributor" or "dealer," most of the states had by 1931 an effectual selective use tax in operation.

The tax cannot be applied solely to the use of gasoline in an instrumentality of interstate commerce operating within a state, it was held in *Helson v. Kentucky*.[38] The gasoline sought to be taxed was purchased in Illinois and used in a ferryboat plying between Illinois and Kentucky, but spending the greater part of its time in Kentucky waters. The imposition by Kentucky of a tax on the gasoline thus used was held bad as a prohibited burden on instrumentalities engaged in interstate commerce. Confined to the precise facts the same result would probably be reached today, but in view of the later decisions there is no doubt that Illinois could tax the sale and delivery of the gasoline in the first instance.

A somewhat similar result was reached in *Bingaman v. Golden Eagle Western Lines*,[39] where an attempt was made to tax gasoline carried into the state in the tanks of buses operating exclusively in interstate commerce. This tax had been construed by the state courts as an excise on the use of gasoline, unconnected with the privilege of using the roads. The Supreme Court held the imposition invalid as a burden prohibited by the commerce clause. If the tax had been tied to the use of the roads, and imposed on some basis which apportioned the amount of

[36] In support of federal power in this respect are Fairfax v. Hunter's Lessee, 7 Cr. 603 (U. S. 1813); Missouri v. Holland, 252 U. S. 416 (1920); Neilson v. Johnson, 279 U. S. 49 (1929); Todok v. Union State Bank, 281 U. S. 281 (1930); Santovincenzo, Consul v. Egan, 284 U. S. 30 (1931).

[37] See Conlon, *Diplomatic and Consular Immunity from Taxation* (Fed. Tax Adm'rs Research Rep. No. 9, 1940), for a discussion of exemptions accorded to these types of consumers.

[38] 279 U. S. 245 (1929).

[39] 297 U. S. 626 (1935).

taxable gallonage to the approximate mileage traveled, there is little doubt that it would have been sustained. It was clearly indicated in *McCarroll v. Dixie Greyhound Lines*[40] that this procedure would be permissible inasmuch as the state is quite within its powers in insisting that interstate instrumentalities using the highways pay road user taxes, just as intrastate traffic does.

In the *Greyhound* case, however, the imposition of the tax was held to be a prohibited burden on interstate commerce for the reason that the base of the tax bore no relation to traveled mileage. The statute provided that 20 gallons of gasoline might be carried into the state in the vehicle tank, tax free.[41] The use tax applied on all gasoline over this exempted gallonage. Since the gasoline in the tank in excess of 20 gallons, the base of the tax, bore no relationship to the distance the bus would travel in the state, the statute fell. It further appears from this case that the tax act or its actual administration must be such that some sort of formal apportionment is made in terms of taxed gallonage to traveled mileage, for it was shown that, as a matter of fact, in the instance in suit the gallonage on which the tax was assessed corresponded roughly to the mileage traveled in the state. The relationship was accidental, however, resulting wholly from the amount of gasoline over 20 gallons the buses happened to be carrying on that occasion.

If the gasoline is sold and delivered within the state, or withdrawn from storage for delivery within the state, it does not matter that it is subsequently used in instrumentalities operated in interstate commerce, even in airplanes or trains, which do not use the public highways.[42] Some state court decisions formerly held that since the tax is for the use of the roads, it could not be applied to gasoline actually used outside the state.[43] However, where the gasoline is sold and delivered, or withdrawn from storage within the state, there is no longer any need to draw this distinction based on the purpose of the tax, or more properly speaking, on the disposition of the receipts from the tax.[44]

Nor is distinction taken between gasoline and articles of general commerce so far as use in instrumentalities of interstate commerce is concerned. The use tax, supplementing the general sales tax, is applicable to those articles destined for use in instrumentalities of interstate commerce if there is even a taxable "instant" between the time their transportation in interstate commerce ceases and their installation in an instrumentality of interstate commerce takes place.[45]

[40] 309 U. S. 696 (1940).

[41] A number of states have similar limitations. See Fed. Tax Adm'rs, *Statutory Provisions Exempting Fuel in Tanks of Motor Vehicles* (1940).

[42] Eastern Air Transport Co. v. South Carolina Tax Comm., 285 U. S. 147 (1932); Nashville, Chattanooga & St. Louis Ry. v. Wallace, 288 U. S. 249 (1933); Edelman v. Boeing Air Transport, 289 U. S. 249 (1933).

[43] Louisiana v. Johnson, 173 La. 669, 138 So. 503 (1931) (on the road tax theory, gasoline used outside the state is not taxable), overruled by State v. Tri-State Transit Co., 179 La. 811, 155 So. 233 (1934) (holding that the tax is an excise on all gasoline sold or consumed within the state). The intervening United States Supreme Court decisions, cited *supra* note 42, influenced the Louisiana court.

[44] Delaware v. Crane Hook Oil Storage Co., 18 A. (2d) 427 (Del. 1941) (there stipulated that only 15% of distance traveled was in Delaware).

[45] Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939); Pacific Tel. and Tel. Co. v. Gallagher,

SALES TO GOVERNMENTS AND THEIR INSTRUMENTALITIES

Governments, federal, state and local, make up a second great class of consumers constitutionally exempt from excises on purchases of materials or services. This intergovernmental exemption is, it is true, usually expressly granted by statute or regulation. Thus the miscellaneous federal excise laws exempt sales to states and their political subdivisions,[46] while under most of the state general and selective sales tax statutes, sales to the United States are exempt.[47] Whether these provisions are the free expression of legislative policy or whether they represent an acceptance of taxing limitations stemming from constitutional roots is a matter not entirely free from doubt. It cannot be said there is an exercise of legislative judgment until a provision of this type remains on the statute books after removal of constitutional bars; and, to be sure, four or five years ago the opinion that constitutional bars do exist in the field of intergovernmental excise taxation was pretty widely, if not universally, held. Developments since that time, discussed more fully below, afford adequate support for the view that the sole test of the validity of such taxation, at least in the absence of legislation by Congress, is whether or not the tax discriminates against those dealing with government.

Development of the Immunity Principle

The development and application of the doctrine of implied intergovernmental immunity, from *McCulloch v. Maryland*[48] to *Graves v. O'Keefe*,[49] for the most part involved other than sales tax cases. However, the principles forming the basis of the decisions did not differ in any essential from tax to tax; in all the assumption was that where a tax laid by the one government impinged on an activity of the other it was a forbidden interference with the carrying on of that government's functions. Indeed, it should be noted, especially of the income tax cases, that not only was the immunity implied but so also was the burden which is the basis of the immunity. In addition to this, the spread of consumption excises latterly provided occasion for several applications of formulated doctrine to this type of tax. The relaxation of the doctrine of implied governmental immunities in the income tax cases, culminating in the *Graves* case and the Public Salary Tax Act of 1939,[50] was not, therefore, without some accompaniment in the excise tax field.

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306 U. S. 182 (1939); Stanolind Pipe Line Co. v. Oklahoma Tax Comm., 113 F. (2d) 853 (C. C. A. 10th, 1940), *cert. denied,* 311 U. S. 693 (1940).

The scope of state power to impose sales and use taxes in the case of transactions of interstate character is canvassed by McNamara, *Jurisdictional and Interstate Commerce Problems in Imposition of Excises on Sales,* and Brown, *The Future of Use Taxes,* both *supra* this issue.

[46] Pistols and revolvers, INT. REV. CODE §2700(b)1; machine guns, *id.* §2721(a); manufacturers' excise and import taxes, *id.* §3442(3); communication facilities, *id.* §3446; bituminous coal (basic tax) *id.* §3522. See also admissions, *id.* §1701(a).

[47] See digests cited note 22, *supra.* Illinois is an exception. The Retailers Occupation Tax does not exempt sales to the United States. See 17 DEC. COMP. GEN. (1937-1938) 863, which distinguishes this tax from the ordinary sales tax.

[48] 4 Wheat. 316 (U. S. 1819).

[49] 306 U. S. 466 (1939).

[50] 53 STAT. 574, 5 U. S. C. A. §84a, 26 U. S. C. A. §22a, 116 (1939).

Panhandle Refining Co. v. Knox[51] held that the Mississippi gasoline tax, in form a tax on the dealer for the privilege of selling gasoline in the state, could not constitutionally be imposed with respect to a sale of gasoline by the dealer to the United States. In *Indian Motorcycle Co. v. United States*[52] it was held that the federal excise tax could not be imposed on the sale of a motorcycle by the manufacturer to a municipality, for use in its police department. A few years later, in *Graves v. Texas Co.*,[53] it was held that a state gasoline tax, in terms laid on the withdrawal of gasoline from storage, was unconstitutional as applied to a withdrawal for the purpose of making delivery on a sale to the United States. The Court viewed storage and withdrawal from storage as essential parts of the sale process, and thought that this was essentially the same type of tax it had struck down in the *Panhandle* case.

Only a year later, however, a West Virginia tax on the gross income of a contractor doing construction work for the United States was sustained by a sharply divided Court in *James v. Dravo Contracting Co.*[54] The contractor had resisted payment of the tax on the ground that the United States would be directly burdened by resultant price increases. The case was twice argued before the Court and the Solicitor General of the United States, appearing *amicus curiae* to present the view of the Government, urged that the tax be upheld. The *Panhandle, Indian Motorcycle* and *Graves* cases, not overruled in so many words by the majority opinion, were distinguished and limited to their particular facts.

The reluctance of the Court to overrule comparatively recent cases is easily understood, but it is not such an easy matter to grasp the distinction between the *Panhandle* and *Dravo* cases. A gross income tax does not differ from a sales tax insofar as the transfer of goods or services is concerned. All other conditions equal, the amount of the tax is added to the price to be paid by the consumer. As a matter of fact all state sales taxes are measured by gross receipts from sales of goods or services even though they differ as to statutory incidence. That is to say, under some of the laws the tax must be passed on to the consumer, while under others its shifting is not required, although actually it takes place. But whether the tax is or is not passed on, the state looks to the seller for the tax and his tax varies exactly with the rise and fall of his gross receipts from sales of goods or services.[55] Since a contractor selling services and materials knows in advance what the tax on his receipts will be he is no differently situated than is a retailer of commodities subject to sales tax; in both instances the tax is an ascertainable cost and must be passed on or absorbed. To say that the cost of the work to a government would not necessarily be increased because competitors might be willing to absorb the tax in their estimated profit rather than lose the contract, disregards the fact that competition on the basis of estimated costs and profits usually decides the award of the contract, even where there is no tax in the offing. Indeed, a gross receipts tax considered in

[51] 277 U. S. 218 (1928).
[52] 283 U. S. 570 (1931).
[53] 298 U. S. 393 (1936).
[54] 302 U. S. 134 (1937).
[55] See note 25, *supra*.

connection with price competition is an extremely rigid item because it is the same for all, whereas in the matter of material and labor costs one contractor may have an advantage over others.

It does not seem possible, therefore, to distinguish the *Panhandle, Indian Motorcycle,* and *Graves* cases on this basis. The vice of the *Panhandle* and *Texas Co.* cases (where the tax was not laid on the sale, nor on the United States, but rather on a seller who had contractual relations with the United States) was that the seller's tax varied directly with his total sales. This, the Court thought, was in effect taxation of the sale itself. Both the dissenters in the *Dravo* case and the Solicitor General who argued it felt that no distinction could be made between it and previous cases. The latter's view is stated by Justice Roberts as follows:[56]

> "The Solicitor General as amicus curiae proposes a single test of the constitutionality of a state tax upon the operations of the United States, or the means chosen for the execution of its powers. That test is whether the taxing statute discriminates against the government and in favor of other taxpayers. He frankly admits that if the proposed criterion be adopted we must overrule *Indian Motorcycle Company* v. *United States,* 283 U. S. 570; *Panhandle Oil Company* v. *Mississippi, supra;* and *Graves* v. *Texas Company,* 298 U. S. 393. He professes himself, as I am, unable to distinguish a sales tax or a tax upon storage preliminary to sale to the United States from a gross receipts tax upon goods and services furnished the government."

The Comptroller General, in common with other federal departmental officers, still regards the *Panhandle* case as controlling.[57] Although this has caused some controversy in a few instances, the conflict which would naturally arise from a diversity of view[58] as to the status of the *Panhandle* case has been avoided to a certain extent because of the fact that many state excise statutes or regulations specifically exempt sales to the United States and their instrumentalities. Developments in connection with cost-plus-a-fixed-fee contractors, discussed more fully below, show that this general situation remained pregnant with possibilities for confusion.

A few state court decisions have sanctioned the imposition of their sales taxes on receipts from sales to instrumentalities of the United States. In California the sales tax, construed as a tax on the seller, was upheld as applied to receipts from sales to a national bank.[59] The North Dakota gasoline tax has been sustained in its application to purchases by a federal land bank.[60] In March of this year the same court held the bank liable for the state sales tax on lumber which it purchased to repair property acquired through foreclosure.[61] Conceding that the tax was on the

[56] James v. Dravo Contracting Co., *supra* note 54, at 170. In its brief the United States had asked "that this Court reconsider its decisions in the *Panhandle, Indian Motorcycle* and *Texas Company* cases and that it extend to the taxing authorities of both the Federal and State governments the latitude which the basis of the doctrine of sovereign immunity from taxation seems properly to permit."

[57] 18 DEC. COMP. GEN. (1938-1939) 832; 19 *id.* (1939-1940) 1, 822. See also 17 *id.* (1937-1938) 863, and compare 19 *id.* (1939-1940) Opinion A-88689, Feb. 28, 1940, distinguishing the Illinois and California sales taxes.

[58] See 39 OP. ATT'Y GEN. (1939) 6.

[59] Western Lithograph Co. v. State Board of Equalization, 11 Cal. (2d) 156, 78 P. (2d) 731 (1938).

[60] Federal Land Bank of St. Paul v. DeRochford, 69 N. D. 382, 287 N. W. 522 (1939).

[61] Federal Land Bank of St. Paul v. Bismark Lumber Co., 297 N. W. 42 (N. D. 1941), *cert. granted,* at request of Solicitor General, 61 Sup. Ct. 1105 (1941).

consumer and not a privilege tax on the seller, the court held that the tax was on a transaction growing out of activities of a non-governmental nature, and that the immunity, express or implied, extended only to those operations of the bank which were of a governmental nature.

The second land bank decision may be vulnerable at several points. First, the Supreme Court has placed stress on the form or statutory incidence of state sales taxes. For example, in upholding the New York City sales tax as applied to interstate shipments, the Court pointed out that the tax was on the buyer and not unlike a use tax.[62] Again, in *Colorado National Bank v. Bedford,*[63] the Court emphasized the fact that the "service" tax in suit was to be paid by the consumer, although the national bank which furnished the "service" (*i.e.,* rented a safe deposit box) was required to collect the tax for the state from the consumer. Had the tax been on the bank it would have violated *Revised Statutes* Section 5219 which limits state taxation of national banks to several specified methods.

In the three cases just mentioned the tax differs in form from that involved in the *Dravo, Texas Co.* and *Panhandle* situations where the tax was in terms imposed on the seller. Economically, there apparently is no difference; in both situations the tax is commonly shifted. However, if the criterion of constitutionality is that the tax be not directly imposed on the United States as buyer, the difference in statutory incidence is important and the "consumer" type of sales tax would be unconstitutional as applied to purchases by the United States. On the other hand, if the criterion of validity is that attributed to the Solicitor General in the *Dravo* case, that is, one of whether the taxing statute discriminates against the government and in favor of other taxpayers, the statutory incidence should not be governing. At least, it should not be governing to a Court which apparently has both eyes cocked for "realities" in tax cases.[64]

Whether there is any virtue in the distinction between the governmental activities of the bank and its additional non-governmental activities, is doubtful. Since the Court has said that all the constitutional activities of the United States are governmental activities,[65] it seems quite unlikely that where a federal department or agency is concerned, it will revert to governmental-proprietary distinctions to decide a case of this type. However, even when such distinctions have formed the basis of the immunity it has been held that the primary purpose of the instrumentality was controlling.[66]

The most important fact about the North Dakota case is that Congress has exempted land banks from all taxation except on the real property which they own.[67] While under ordinary circumstances at any rate, one may question the

[62] *Cf.* note 25, *supra.*

[63] *Supra* note 25.

[64] *See* for example in the present term, Helvering v. Horst, 311 U. S. 112 (1940); Helvering v. Eubank, 311 U. S. 122 (1940); Wisconsin v. J. C. Penney Co., 311 U. S. 435 (1940); Superior Bathhouse Co. v. McCarroll, 312 U. S. 176 (1941); Helvering v. LeGierse, 312 U. S. 625 (1941).

[65] Pittman v. Home Owners' Loan Corp., 308 U. S. 21 (1939).

[66] New York *ex rel.* Rogers v. Graves, 299 U. S. 401 (1936).

[67] 39 STAT. 380 (1916), 12 U. S. C. §§931-33 (1934).

fairness of permitting a government corporation to engage in competitive enterprise while at the same time favoring it with a tax differential, nevertheless it appears that if Congress deems this condition necessary or desirable its action in the matter is conclusive.[68]

Post Exchanges

Two comparatively recent problems have appeared to focus attention anew on the question of intergovernmental immunities. The first involves the taxation of sales to or by post exchanges and similar voluntary unincorporated organizations of army and navy personnel.[69] Although not created by statute, post exchanges are operated under regulations[70] prescribed by the Secretary of War and most of them are located on lands over which the United States has exclusive jurisdiction. They are authorized to sell articles of common use to soldiers and other personnel of the camp or reservation where they are located. No private gain inures from their operation, the allowed profit going to the common funds of the companies or units which compose the post exchange.

With the passage of the Buck Act in 1940,[71] the territorial tax immunity of transactions taking place on federal reservations was removed, but that immunity is not waived where sales by a federal instrumentality are concerned. Under this act, therefore, the liability for taxes of the post exchange or of authorized purchasers from post exchanges depends expressly on whether the post exchange is a federal instrumentality.[72] The cases conflict on the status of these exchanges.[73] A recent decision, *United States v. Query*,[74] held an exchange to be a federal instrumentality and enjoined the South Carolina Tax Commission from enforcing its license tax (really a sales tax) on goods sold by the exchange. Previously in 1937, in a similarly entitled case, the same conclusion was reached with respect to a post

[68] "In the exercise of this power to protect the lawful activities of its agencies, Congress has the dominant authority which necessarily inheres in its action within the national field." Pittman v. Home Owners' Loan Corp., *supra* note 65, at 33.

[69] These consumption taxes would eventually be paid by the consumer or purchaser from a post exchange. However, if in the case of cigarettes and beer the exchange refuses to buy taxpaid commodities, or in the case of the general sales tax to collect and pay the tax to the state, the consumer is relieved of the tax. On the status of the post exchange depends the consumer's liability for tax.

[70] A. R. No. 210-65, C-1, C-3. For other types of associations see War Dept. Circular No. 13, Jan. 21, 1941.

[71] 54 STAT. 1059, 4 U. S. C. A. §§12 *et seq.* (1940). Congress had previously required post exchanges to collect and remit to the states, gasoline taxes on motor fuel sold for other than the exclusive use of the United States. 49 STAT. 1521, 4 U. S. C. A. §12 (1936).

[72] Section 3 of the Buck Act states: "The provisions of . . . this Act shall not be deemed to authorize the levy or collection of any tax on or from the United States or any instrumentality thereof, or the levy or collection of any tax with respect to sale, purchase, storage, or use of tangible personal property sold by the United States or any instrumentality thereof to any authorized purchaser." 54 STAT. 1060, 4 U. S. C. A. §15 (1940).

[73] Federal administrative officials have held the post exchange to be a federal instrumentality. See the opinion of the Attorney General, *supra* note 58; War Dept. Circular No. 13, *supra* note 70; and the instances cited in United States v. Query, *infra* note 74. To the same effect are rulings of the attorney generals of Alabama (Dec. 31, 1940) and Ohio (Jan. 24, 1941). The attorney generals of Connecticut (Dec. 30, 1940), New York (Dec. 23, 1940) and Texas (May 7, 1940) take the opposite view. See Fed. Tax Adm'rs, *Status of Voluntary Associations of Service Personnel for Tax Purposes* (1940).

[74] 37 F. Supp. 972 (E. D. S. C. 1941).

exchange operated in conjunction with a Civilian Conservation Corps camp.[75] The creation of C. C. C. post exchanges is expressly authorized by statute but no immunity from taxation is granted.[76] In addition to these cases, the United States Court of Claims has also held that post exchanges are federal instrumentalities.[77] The opposite view, that a post exchange is simply a voluntary cooperative organization of individuals, has been taken by the Fifth Circuit court of appeals and the supreme court of California.[78]

The tax liability of vendors for goods sold to post exchanges is governed by the same considerations discussed in connection with the *Panhandle* and *Dravo* cases.[79] As a practical matter the state tax administrator cannot force the collection of tax on sales to post exchanges. If the post exchange refuses to pay the tax the dealer, usually a wholesaler, is faced with the alternatives of absorbing the tax or turning away the custom since the post exchange can buy supplies tax free simply by ordering them from outside the state.[80] Because the tax may be rather high on an *ad valorem* basis, the effect of attempted enforcement is to deprive local sellers of the exchange's custom. Precisely for this reason several states have had to revise their rulings to exempt sales to post exchanges, and three states, New York, Pennsylvania and Texas, have by statutes enacted this year granted similar exemptions.[81]

Cost-Plus Contractors

To push the defense program forward as quickly as possible, the United States is authorized, under certain conditions,[82] to enter into cost-plus-a-fixed-fee contracts.[83] Since under most sales tax statutes the contractor is regarded as the consumer of the materials he buys, the seller is liable for sales taxes on materials bought in fulfillment of these contracts and, of course, adds the tax to the contractor's invoice. Some of the earlier contracts specifically included applicable state and local taxes as allowable costs for purposes of reimbursement to the contractor,[84] but contracting officers now refuse to recognize a state sales tax as an allowable cost.[85] The ground

[75] United States v. Query, 21 F. Supp. 784 (E. D. S. C. 1937).

[76] 50 STAT. 320, 16 U. S. C. A. §584(c), (p) (1937).

[77] Dugan v. United States, 34 Ct. Cl. 458 (1899); Woog v. United States, 48 Ct. Cl. 80 (1913).

[78] Pan American Petroleum Corp. v. Alabama, 67 F. (2d) 590 (C. C. A. 5th, 1933); People v. Standard Oil Co. of California, 218 Cal. 123, 22 P. (2d) 2 (1933), *rev'd* on another ground *sub. nom.* Standard Oil Co. of California v. California, 291 U. S. 242 (1934). *Accord:* Keane v. United States, 272 Fed. 577 (C. C. A. 4th, 1921).

[79] The Attorney General, though holding post exchanges to be federal instrumentalities, has recommended that the Federal Government take no part in any effort to collect taxes from dealers selling to post exchanges. Opinion of the Attorney General, *supra* note 58.

[80] Sales requiring shipping to points outside the state are in all jurisdictions exempt from general and selective sales taxes.

[81] N. Y. Laws 1941, c. 351; Pa. Laws 1941, act No. 34; Tex. Laws 1941, S. B. No. 91.

[82] 53 STAT. 590, 34 U. S. C. A. §556, 53 STAT. 652, 5 U. S. C. A. §118(e) (1939); 54 STAT. 676, 712, 50 U. S. C. A. App'x 1, 2 (1940).

[83] For a description of this type of contract see U. S. Navy Dep't, Bureau of Yards and Docks, *Some Commentaries on Cost-Plus-a-Fixed Fee Contracts* (1940).

[84] See the discussions in Fed. Tax Adm'rs, *Status of Cost-Plus Contractors with the United States* (1940); Nat. Ass'n of Manufacturers' Law Digest, *National Defense Contracts* (Oct.-Nov. 1940).

[85] U. S. Navy Dep't, *supra* note 83, at 18.

for the refusal is that the cost-plus contractor is merely an agent of the United States and that the *Panhandle* case prevents a tax on sales to the United States. Much reliance is placed on the fact that the United States takes title to all materials delivered to the contractor, although there is some evidence that the title-taking provision was primarily intended to minimize insurance costs by removing the risk of loss from the contractor. Some of the contracts have also required prior approval of the government officer on any orders for materials costing in excess of $500.

Only one court has thus far ruled on the taxability of such sales. The supreme court of Florida held that a distributor of gasoline is liable for the state gasoline tax on motor fuel sold to a cost-plus contractor fulfilling a defense contract with the United States.[86] The court inclined to the view that the *Panhandle* case was no longer controlling but also emphasized the fact that the particular contract itself provided that all applicable state and local taxes should be allowable costs to the contractor. Of some bearing, however, is the further case of *Boeing Airplane Co. v. Comm. of Revenue and Taxation*,[87] where the Kansas supreme court held that state sales or use taxes might be imposed on materials bought by an airplane manufacturer to construct an emergency defense airplane plant. Title to the plant was in the manufacturer's name but was to be transferred to the United States in five years, at which time the Government would have reimbursed the manufacturer for the cost of the plant.

Administrative rulings on the liability of cost-plus contractors to sales tax are by no means uniform.[88] The North American Gasoline Tax Conference, considering the matter at its 1940 meeting,[89] approved the view that the cost-plus contractor was essentially an independent contractor rather than an agent of the United States and, therefore, liable for motor fuel taxes under the holding in *Trinity Farm Construction Co. v. Grosjean*.[90]

A recent statement of the policy of the Department of Justice, however, indicates an opposing position. Acting Attorney General Biddle in a memorandum under date of June 5, 1941, has declared that the Department views the cost-plus-a-fixed-fee contractor as an instrumentality of the United States, and will contest the imposition of taxes whose legal incidence is on the contractor as purchaser. Also challenged are those sales taxes which the seller is directed by statute to collect from the purchaser or to pass along to the purchaser. This is, of course, on the theory that the legal incidence of these taxes falls directly on the United States. Pursuant to this policy the Federal Government has become a party plaintiff in one case and has intervened in another, both in Alabama, where sales and use tax assessments have been made against a merchant selling to a cost-plus-a-fixed-fee contractor. In *United States, Dunn Con-*

[86] Standard Oil Co. v. Lee, 142 Fla. 906, 199 So. 325 (1940).
[87] 113 P. (2d) 110 (Kan. 1941).
[88] TAX ADMINISTRATORS NEWS (Jan., Feb., March, April, 1941).
[89] PROC. NORTH AMER. GASOLINE TAX CONF. (1940) 79-82.
[90] 291 U. S. 466 (1934).

struction Co. et al. v. Curry, and *King and Boozer v. Alabama,* the circuit court of Montgomery County, Alabama, on June 13, 1941, upheld imposition of the state's sales and use taxes. An authoritative determination of the question by the United States Supreme Court early in the 1941 term may thus be possible.

If the test be statutory incidence, the line of demarcation between valid and invalid taxes under the implied intergovernmental immunity rule will be easily but not satisfactorily drawn. For example, the omission of the shifting provision in some state sales tax laws will convert them into occupational or privilege taxes as far as legal incidence is concerned. However, if the shifting continues, and experience and business practice indicate that it will, the effect in dollars and cents on the government which contracts or purchases will remain unchanged. For a clear-cut solution of this problem it seems necessary to recognize that a genuine public immunity and not a private immunity is involved in cases where excise taxes on sellers to or contractors with governments are concerned. The decision then to be made is whether governments are to bear the increased costs that result from taxes which are segregable in fact rather than in legal incidence.

Congress has on at least two occasions refused to exercise the power accorded it by the recent Supreme Court determinations to exempt from federal, state and local taxation materials used by these cost-plus contractors. In both instances the legislation authorizing the use of cost-plus contracts carried language that would have made the contractors agents or instrumentalities of the United States.

Proprietary Activities of the States

Because all constitutional activities of the United States are judicially conceived to be governmental,[91] there is little likelihood that the governmental-proprietary distinction will sustain the validity of a state or local tax impinging on some federal activity. This distinction, however, does serve as the basis for upholding federal taxes on the activities of states and local governments. State monopoly systems for dispensing liquor, and state university athletic exhibitions to which an admission fee is charged furnish instances where federal taxes must be paid on activities conducted under governmental authority.[92] It might also be noted here that states and their political subdivisions must pay federal taxes which in terms are not imposed on sales even though it is obvious that the tax is passed on and might easily be segregated. For example, the federal cigarette tax, amounting now to six and one-half cents per package, is imposed on the manufacturer of cigarettes. The Supreme Court has upheld the inclusion of this amount in the price paid by a state for cigarettes purchased for use in its public institutions, without considering whether the operation of a hospital was a governmental activity.[93]

[91] Pittman v. Home Owners' Loan Corp., *supra* note 65.

[92] South Carolina v. United States, 199 U. S. 437 (1905); Ohio v. Helvering, 292 U. S. 360 (1933); Allen v. Board of Regents, 304 U. S. 439 (1938).

[93] Liggett and Myers Tobacco Co. v. United States, 299 U. S. 383 (1937).

ADMINISTRATION OF EXEMPTIONS AND REFUNDS

When a class of consumers is relieved of excise taxes there are two ways in which the privilege may be made effective. The sale may be exempted in the first instance so that no tax is ever paid on it or payment of the tax may be required in the first instance and a refund or reimbursement made later. In connection with general and selective sales taxes, except the tax on gasoline, the exemption method is commonly used. Under the gasoline tax the refund system has generally been adopted except on sales to the United States. The exemption method is more acceptable to the taxpayer since he does not have to go to the trouble of applying for a refund. It is less satisfactory to the administrator though, unless exemption certificates are secured on every sale and even then there remains a great possibility of evasion.[94]

The general sales tax is better adapted to the use of the exemption than is the gasoline tax for two principal reasons. First, the primary responsibility for the sales tax rests on the retailer who makes the sale to the consumer; in other words, it is on the last seller to the taxpayer. When, therefore, he sells the goods he knows whether the buyer is of the exempt class. Hence to put the exemption into operation the retailer merely excludes the proceeds of that sale from his ordinary taxable receipts. Under the motor fuel tax the first handler, usually called the importer or distributor, is ordinarily liable for the tax. When he sells to a sub-distributor and the latter to a dealer and so on down the line until the fuel is finally sold to a consumer, the tax is included because at the time the distributor makes the first sale and adds the tax, he does not know what type of consumer will eventually buy the gasoline. The second reason for the difference lies in the relative rates of the two taxes expressed on an *ad valorem* basis. The general sales tax rate is only two or three per cent. The lowest gasoline tax, two cents per gallon, is more than ten per cent of the retail price on an *ad valorem* basis, while some of them run over 25 per cent. This greater incentive to evasion in connection with a commodity in such wide use as gasoline makes it necessary for the gasoline tax administrator to check exemptions and refunds very carefully lest the tax base be seriously diminished.

When the exemption method is used the seller may be required to support his deduction for non-taxable sales by an exemption certificate signed by the buyer. The United States furnishes such a certificate (Standard Form 1094) on its purchases. This is accepted in lieu of the tax by the seller and is in common use under all types of sales taxes, including the gasoline tax. Sometimes copies of the invoices are required to accompany Form 1094 in support of the deduction while in some states copies of the invoices alone are required. Some administrators require the invoice on the ground that it is better proof of the sale and delivery to the Government than is Form 1094 because the latter might possibly be obtained and used by unauthorized persons and might also be used to cover a number of individual transactions. Where

[94] For a general treatment see, JACOBY, RETAIL SALES TAXATION (1938) *passim;* CRAWFORD, *loc. cit. supra* note 10; Report of the Kansas Legislative Council, *Gasoline Tax Exemptions* (1937); ANN. PROC. NAT. ASS'N TAX ADM'RS; ANN. REP. NORTH AMER. GASOLINE TAX CONF.

sales are made to others than consumers the deduction may sometimes be taken without explicit proof of the sales tax return. The seller is required to keep copies of his invoices, delivery sheets and other such memoranda on file in his office and these are checked by auditors and investigators in their periodic examinations.

Exemption procedure when used in connection with the gasoline tax usually requires the user to secure a permit to buy gasoline tax free. This requirement may also apply to a seller of exempt fuel. The invoice must have the permit number of the buyer, and in addition the buyer may be required to sign a manifold exemption slip, one part of which he keeps and the other the seller retains to substantiate the deduction he takes on his return. At least three states use the exemption method at the present time, Kansas, North Dakota and Oklahoma. The latter originally used the exemption system, changed to the refund and finally returned to the exemption system after a more carefully considered procedure had been worked out for administration.

While the present Oklahoma system seems to provide an adequate check on evasion, the exemption method for gasoline has been abused in several states and tax administrators generally favor the refund method for other than sales to the United States. The simplest form of refund procedure required only that the purchaser make claim for the refund under affidavit setting forth the gallonage used and the tax, supported by a copy of the invoice. Continuous development of stricter procedures has led to many refinements during the past decade. In some states a permit to use gasoline for refundable purposes must be secured or no refund may be obtained. Pertinent information as to the type and extent of use must be furnished. From this it is possible to work out a quota for the user. This quota, although only an approximation, nevertheless serves as an indicator and fluctuations in it may warrant the sending of a field investigator for a check-up. The refund claim must usually be filed within a specified time and in some states, to avoid a multiplicity of small refund checks, must be for a minimum number of gallons. In some states the purchase of refund fuel must be made in specified lots. The use of coloring for refund fuel and segregation of it in special tanks have also been adopted as methods of preventing evasion of the tax through use of the refund privilege. Another requirement to prevent fraud is that the purchaser of refundable fuel state at the time of purchase that it is bought for this purpose, notation on the invoice being necessary to securing of a refund.