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United States v. New Mexico {102 S. Ct. 1373}: Reassessment of Federal Contractors' Constitutional Immunity from State Taxation

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UNITED STATES v. NEW MEXICO: REASSESSMENT OF FEDERAL CONTRACTORS' CONSTITUTIONAL IMMUNITY FROM STATE TAXATION

The manner in which courts apply the doctrine of constitutional immunity from state taxation[1] affects the vitality of state govern-

1 Chief Justice Marshall announced the doctrine of federal constitutional immunity from state taxation in M'Culloch v. Maryland 17 U.S. (4 Wheat.) 316 (1819). The doctrine is a theory of constitutional law absolutely barring states from levying taxes on the national government and its instrumentalities. *See* Gillespie v. Oklahoma, 257 U.S. 501, 505 (1922) (Holmes, J.) (rule against taxing instrumentalities of the United States is absolute in form and strict in substance); Johnson v. Maryland, 254 U.S. 51, 55 (1920) (Holmes, J.) (no matter how reasonable, universal, or nondiscriminatory the levy, a state may not interfere with the United States by taxation); Home Ins. Co. v. New York, 134 U.S. 594, 598 (1890) (states may not impede, burden, or in any manner control the United States through taxation); Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449, 468 (1829) (Marshall, C.J.) (states may not tax in a way that directly or indirectly burdens the United States; extent of burden is irrelevant); M'Culloch v. Maryland 17 U.S. (4 Wheat.) 316, 436-37 (Marshall, C.J.) (state tax on an instrument of the United States is unconstitutional). *See generally* G. GUNTHER CASES AND MATERIALS IN CONSTITUTIONAL LAW 358-69 (1980); Pierce, *Tax Immunity Should Not Mean Tax Inequity,* 1959 WIS. L. REV. 173 (sketches pre and post 1937 development of doctrine, contends that the doctrine impairs the states' ability to meet the rising cost of state government); Powell, *The Remnant of Intergovernmental Tax Immunities,* 58 HARV. L. REV. 757 (1945) (analysis of doctrine's development from 1937 to 1945) [hereinafter cited as Powell, *Remnant*]; Powell, *The Waning of Intergovernmental Tax Immunities,* 58 HARV. L. REV. 633 (1945) (detailed analysis of development and trends in the doctrine through 1937) [hereinafter cited as Powell, *Waning*]; Tribe, *Intergovernmental Immunities in Litigation, Taxation, and Regulation: Separation of Powers Issues in Controversies about Federalism,* 89 HARV. L. REV. 682, 700-11 (1976); Comment, *Federal Immunity from State Taxation: A Reassessment,* 45 U. CHI. L. REV. 695 (1978) (traces historical development of doctrine; criticizes its absolutism).

Although the doctrine is a theory of constitutional law, it is not mentioned in the Constitution. Its foundation is the constitutionally implied relationships between the federal government and the governments of the individual states. C. BLACK, STRUCTURE AND RELATIONSHIP IN CONSTITUTIONAL LAW 15 (1959). National supremacy is central to the doctrine. *Id. See infra* notes 14-30 and accompanying text for a discussion of early development of the doctrine.

ments.[2] Nevertheless, the United States Supreme Court has not uniformly applied the doctrine to contractors with the federal government.[3] In *United States v. New Mexico,*[4] the Court found contractors with the Department of Energy outside the umbrella of federal immunity.

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2. *See* Pierce, *supra* note 1, at 174, 189.

During the 1974-75 fiscal year, the states spent $86,326,000,000. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, GF 75 No. 5, GOVERNMENTAL FINANCES IN 1974-75, at 21 (1976). They spent $224,644,000,000 during the 1978-79 fiscal year. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, GF 79 No. 5, GOVERNMENTAL FINANCES IN 1978-79, at 5 (1980) [hereinafter cited as GF 79]. In four years, therefore, state expenditures increased 260%. While growth of state tax revenue paralleled growth of state expenditures, state expenditures have risen faster than state tax income. R. LEACH, AMERICAN FEDERALISM 211 (1970).

A state tax on federal activities within the state's borders would ease the state's revenue woes. The contemporary doctrine of constitutional federal immunity from state taxation, however, precludes the states from levying any tax on the federal government. *See* Comment, *supra* note 1, at 706. If the immunity applied only to discriminatory state taxes, states could levy a sales tax on a federal purchaser. The federal government paid $199,000,000,000 for goods and services during 1980. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1981, at 421 (1981). The government undoubtably made the vast majority of those purchases in these states. A 5% state sales tax on 1980's federal government purchases would yield almost $10,000,000,000. *See* GF 79, *supra.* Sales tax is only one example of state taxes the federal government does not pay. The manner of applying the doctrine, therefore, controls state access to a substantial source of revenue.

3. Before 1937 the Supreme Court liberally found immunity per the *M'Culloch* doctrine. The Court "almost always" found immunity whenever a state tax on a party dealing with the federal government raised the cost of a federal operation. Tribe, *supra* note 1, at 703, 706. In 1937, the Court decided James v. Dravo Contracting Co., 302 U.S. 134 (1937). *Dravo* upheld a nondiscriminatory state tax on a contractor's earnings from work performed within the state under a federal contract. *Id.* Since *Dravo,* the Court has rarely found immunity per the *M'Culloch* doctrine. *See* Tribe, *supra* note 1, at 704. The Court tends to find immunity only if the "legal incidence" of a tax is on the United States. *See* Comment, *supra* note 1, at 701-06. Nevertheless, some post-1937 decisions are inconsistent or turn on formal distinctions. *Compare* United States v. Allegheny County, 322 U.S. 174, 192 (1944) (invalidated tax on federal property for-profit contractor used and possessed) *and* Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110, 116-22 (1959) (because contract called contractor agent, Court invalidated sales tax on contractor building navy ammunition depot) *with* City of Detroit v. Murray Corp. of America, 355 U.S. 489, 493 (1958) (sustained personal property tax on federal property contractor possessed and used for personal benefit) *and* Alabama v. King & Boozer, 314 U.S. 1, 8-9 (1941) (upheld sales tax on contractor building army base) *and* James v. Dravo Contracting Co., 302 U.S. 134 (1937) (exemption of federal agencies from state taxation does not depend upon the fact that they are agents).

4. 455 U.S. 720 (1982).

The United States sought exemptions[5] from New Mexico's gross receipts, sales, and use taxes[6] for three firms contracting with the Department of Energy.[7] An advanced funding procedure provided fed-

5. *See* United States v. New Mexico, 455 F. Supp. 993 (D. N.M. 1978). In the principal case, New Mexico levied taxes on the contractors, not directly on the federal government. Nevertheless, the United States challenged the taxes. Both the United States and the Contractor have standing to question the propriety of a tax on the contractor doing business with the federal government. *See* United States v. Allegheny County, 322 U.S. 174, 191 (1944).

6. N.M. STAT. ANN. §§ 72-16A-4, 72-16A-7 (Supp. 1975) (superseded code). New Mexico's gross receipts tax was a 4% levy on the total revenue of each business in the state. N.M. STAT. ANN. § 72-16A-4 (Supp. 1975) (superseded code). The state assessed the tax for the privilege of doing business in New Mexico. *Id.*

The legal incidence of the tax falls upon the seller of goods or services, rather than the buyer. *See* brief for New Mexico at 6, United States v. New Mexico, 455 U.S. 720 (1982) [hereinafter cited as Brief for New Mexico]. *See also,* Brief for the United States at 25, United States v. New Mexico, 455 U.S. 720 (1982) [hereinafter cited as Brief for the United States]. In practice, however, New Mexico arguably levies a gross receipts tax only against those "engaged in the construction business or in performing services of a professional, technical, or scientific nature." *See id.* at 6. Those selling goods effectively collect a sales tax from customers. *See id.* New Mexico contends that no part of the gross receipts tax is legally comparable to a sales tax. Brief for New Mexico at 6. Nevertheless, the Court treated the gross receipts tax as a tax on sales to the contractors. *See* United States v. New Mexico, 455 U.S. at 741.

New Mexico's use tax was a levy on the value of goods purchased out of state but used in New Mexico. N.M. STAT. ANN. § 72-16A-7 (Supp. 1975) (superseded code). The tax was 4% of the property's value. *Id.* The state determined value as of the purchase date or the date of introduction into New Mexico, whichever was later. *Id.* New Mexico levied the tax, however, only if the owner acquired the property in the kind of transaction subject to the state's gross receipts tax. *Id.* The state levies the tax "to protect New Mexico businessmen from the unfair competition that would otherwise result from the importation of property into the state without payment of a similar tax." N.M. STAT. ANN. § 72-16A-2 (Supp. 1975) (superseded code). Thus, a New Mexican buyer cannot avoid the state's 4% tax by making purchases out of state.

New Mexico amended its tax code in 1978. The state lowered the rate of its gross receipts and compensating taxes from 4% to 3½%. N.M. STAT. ANN. §§ 7-9-4, 7-9-7 (Supp. 1982). The federal government filed the claim involved in *United States v. New Mexico* before New Mexico amended its tax code. None of the changes in the code are important here. *See* 455 U.S. 720, 727 n.7.

7. The contractors were Sandia Corporation, a subsidiary of Western Electric Company, Inc.; the Zia Company, a subsidiary of Santa Fe Industries, Inc.; and Los Alamos Constructors, Inc., a subsidiary of Zia. Sandia was organized in 1949 and does only federally sponsored research. It manages Sandia Laboratories, a federally-owned installation in Albuquerque, New Mexico. Paid-in capital of $1,000 in United States bonds is Sandia's only property. Unlike Sandia, Zia owns property and does private work. Zia manages the federally-owned Los Alamos Scientific Laboratory. Zia organized Los Alamos Constructors in 1953. Los Alamos does only construction and repair work at the federal installation Zia manages. Los Alamos Constructors

eral monies to pay for the contractors' purchases.[8] The contractors purchased goods in their own names but title passed directly to the United States.[9] Unknown to vendors, only the federal government

owns no personal property and makes all of its purchases through Zia. *See* United States v. New Mexico, 455 U.S. at 723-24.

New Mexico's gross receipts tax, *see supra* note 6, affected the contractors in three ways. First, the state taxed fees the United States had paid the contractors. *See* 455 U.S. at 728. Second, Sandia and Zia had to pay tax on their purchases. *Id.* The statute, however, expressly exempted sales to the United States from taxation. N.M. STAT. ANN. § 72-16A-14.9 (Supp. 1975) (superseded code). Finally, the contractors had to pay tax on funds the United States advanced for the contractor's purchases. 455 U.S. at 728. The United States did not question New Mexico's levy on fees paid to the contractors. Brief for the United States, *supra* note 6, at 15.

New Mexico expressly exempted the United States from its use tax. N.M.. STAT. ANN. § 72-16A-12.3 (Supp. 1975) (superseded code). Nevertheless, New Mexico levied the tax on the contractors' in-state use of federal property purchased outside New Mexico. 455 U.S. at 728.

The contractors involved here made agreements with the Atomic Energy Commission (AEC). In 1975, the United States transferred responsibility for the nation's nuclear program from the AEC to the Energy Research and Development Administration. 455 U.S. at 723 n.1. The Depart of Energy (DOE) assumed responsibility for the program in 1977. *Id.* Thus, the contracts were between (DOE) and the contractors at the times in question.

8. United States v. New Mexico, 455 U.S. at 725. The Supreme Court described advanced funding as an accounting device

> designed to provide up-to-date meaningful records of costs and controls of property, as well as to 'speed up reimbursement of contractors.' . . . The procedure allows contractors to pay creditors and employees with drafts drawn on a special bank account in which United States Treasury funds are deposited. . . . The contractor pays its expenses by drawing on the account. . . . The United States owns the account balance.

455 U.S. at 725-26. The court of appeals similarly described advanced funding, dismissing it as "simply another means of reimbursement designed by accountants." New Mexico v. United States, 624 F.2d 117, 122 (10th Cir. 1980).

The United States strenuously objected to the courts' suggestion that advanced funding is "simply" an accounting device. *See* Brief for the United States, *supra* note 6, at 14, 33. The government insisted that there is a "considerable difference between the case where the contractor expends its own funds and must await reimbursement . . . and the case in which the contractor is empowered to draw directly on the funds of the government." *Id.* at 14, 33. The United States' argument proceeded as follows. First, the advanced funding procedure effectively gave the contractors power to commit the federal government's credit. *See id.* at 33. Second, the power to commit federal funds made the contractors federal agents. *Id.* Third, federal agents are cloaked with federal immunity from state taxation according the Kern-Limerick, Inc. v. Scurlock, 347 U.S. 154 (1954). *Id.* at 19-20. *See infra* notes 52 to 62 and accompanying text for a discussion of *Kern-Limerick.*

9. 455 U.S. at 724. The contractors never had an owner's interest in their purchases. *Id.*

had an independent interest in the purchases.[10] Each contractor stood to benefit from its relationship with the federal government.[11] Rejecting the government's agency based argument for immunity,[12] a unanimous Supreme Court affirmed the court of appeals' judgment for New Mexico.[13]

10. *Id.* at 1387. *But see* Brief for the United States, *supra* note 6, at 31. In its brief, the United States argues that vendors had notice of the government's ultimate interest in purchases by Sandia or Zia. The government notes that Zia's checks stated, "A.E.C. Advance Funds/Payroll Account . . . " or "U.S. Energy Research and Development Administration Advance Funds Account." *Id.* Similarly, Sandia's checks stated, "Sandia Laboratories . . . Operated by Sandia Corporation [for] Energy Research and Development Administration/Advance Funds Account." *Id.* The legends on the contractors' checks arguably notify vendors that the United States is the real purchaser when the contractors buy goods. Such notice is important because the Court cites lack of such notice to distinguish *United States v. New Mexico* from arguably controlling precedent. *See infra* notes 112-113 and accompanying text. Despite the importance of the point, the court fails to address the government's argument.

11. *See* 455 U.S. at 724 & n.3, 740 n.13. Zia and Los Alamos Constructors had cost-plus-fixed-fee contracts. Clearly, fees received over and above costs are benefits. Sandia's profit, however, is not so apparent. Sandia and its parent, Western Electric, "are guaranteed royalty-free irrevocable licenses for any communications related discoveries or inventions developed by most Sandia employees during the course of the contract . . . and the company receives complete reimbursement for salary outlays and other expenditures." *Id.* at 740 n.13. Thus, Sandia gains free training for its employees, free research facilities, and free use of government-owned inventions or discoveries. *Id.* at 724 n.3.

12. *Id.* at 742-43. *See infra* note 8, 88 and accompanying text for discussions of the United States' argument.

13. *Id.* at 744. The district court held the contractors immune from New Mexico's gross receipts tax as applied to purchases. United States v. New Mexico, 455 F. Supp. 993, 997-98 (D. N.M. 1978). The court found the contractors to be procurement agents for the United States because the government retained control of the contractors' actions while permitting the contractors to buy property for the government with federal monies. *Id.* The court relied on Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954). *See id.* at 455 F. Supp. at 996-97. In that case, the Supreme Court had held a federal procurement agent immune from a state sales tax. *See infra* notes 52-62 and accompanying text discussing *Kern-Limerick.* The court also found New Mexico's compensating tax to be merely a correlate of the state's sales tax. *Id.* at 998. The court, therefore, again employed its sales tax rationale to hold the contractors immune from the use tax. *Id.* Finally, the court held that funds advanced for purchases are not compensation and, therefore, not taxable as gross receipts. *Id.* at 997-99.

The Tenth Circuit reversed the district court's judgment, emphasizing a policy of maintaining "the delicate financial balance between our coexisting sovereignties." *See* New Mexico v. United States, 624 F.2d 111, 116 (10th Cir. 1980). The court of appeals found the contractors insufficiently incorporated into the government to warrant calling them instrumentalities. *See id.* at 118. Only a federal instrumentality, the

Chief Justice Marshall announced the doctrine of constitutional federal immunity from state taxation in *M'Culloch v. Maryland.*[14] In *M'Culloch,* the state of Maryland sued the cashier of the Baltimore branch of the Bank of the United States[15] for issuing notes without paying a discriminatory state tax.[16] Chief Justice Marshall held the legislation incorporating the bank a constitutional exercise of Congress' powers because the Bank was Congress' instrument for achieving enumerated constitutional goals.[17] Chief Justice Marshall argued

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appellate court asserted, can claim federal immunity from state taxation. *Id.* (citing United States v. Boyd, 378 U.S. 39, 43 (1964)). *See infra* notes 63-72 and accompanying text for a discussion of *Boyd.*)

The Supreme Court granted certiorari "to consider the seemingly intractable problems posed by state taxation of federal contractors." *United States v. New Mexico,* 455 U.S. 730.

14. 17 U.S. (4 Wheat.) 316 (1819).

15. The Act of April 10, 1816, ch. 44, 3 Stat. 266 authorized creation of the Bank of the United States. The United States' first constitutional Congress had previously established a bank, but its authorizing legislation had expired. *M'Culloch v. Maryland,* 17 U.S. (4 Wheat.) at 402.

16. Maryland's statute required banks and branches of banks lacking a Maryland charter to issue notes only on specifically stamped paper available from the state. The state charged a tax upon issuance of the paper. The levy was proportional to the value of the note to be issued. Banks could avoid the tax only by advance payment of an annual state fee. The Baltimore branch of the Bank of the United States was the only bank without a Maryland charter in the state. The notes it issued were not on Maryland's stamped paper. The bank had not paid the state's annual fee. 17 U.S. (4 Wheat.) at 319 (reporter's statement of facts).

17. *See* 17 U.S. (4 Wheat.) at 421-24. Note that Chief Justice Marshall implicitly assumed that Congress' enumerated powers under the Constitution, art. I, § 8, are ends for congressional achievement. *Id.*

Chief Justice Marshall made two arguments to support the holding that Congress may constitutionally charter a bank. The first argument begins with the premise that the federal government may exercise only those powers the Constitution grants it. *Id.* at 405. The Constitution gives Congress power to collect taxes, borrow money, regulate commerce, declare and conduct war, and raise and support an army and navy. *Id.* at 407. A government entrusted with such powers must have ample means for their execution. *See id.* at 408-09. The Constitution does not bar creation of a corporation if a corporation is essential to the beneficial exercise of Congress' enumerated powers. *Id.* at 408. Corporations are means to an end. They are not ends in themselves. *Id.* at 408. Therefore, the Constitution implies that Congress has the power to create corporations, including banks. *See id.* Thus, the legislation incorporating the Bank was a law "of the United States . . . made in Pursuance" of the Constitution and, consequently, was the supreme law of the land. *See* U.S. CONST., art. VI, cl. 2.

The second argument rests on the "necessary and proper" clause. Article I, § 8 of the Constitution expressly gives Congress power "to make all laws which shall be Necessary and Proper for carrying into Execution" Congress' enumerated powers. *Id.* at 411-12. The "necessary and proper" clause, therefore, makes constitutional all

that taxation of congressional means or instruments for achieving constitutional goals contravenes the Constitution's supremacy clause.[18] Chief Justice Marshall concluded, therefore, that states may not tax valid congressional enactments effectuating legitimate federal exercises of constitutional authority.[19]

The *M'Culloch* opinion fashions an absolute immunity from state taxation for the federal government and its instrumentalities.[20] Nev-

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means that are appropriate to a legitimate goal and not otherwise prohibited. *Id.* at 421. Thus, the act to incorporate the bank is a constitutional means for Congress' execution of its enumerated powers. As such, it is a part of the supreme law of the land. *Id. See generally* G. GUNTHER, *supra* note 1, at 92-106.

18. *See* 17 U.S. (4 Wheat.) at 426, 430. The "supremacy" clause states:

> This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made or which shall be made, under the authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST., art. VI, cl. 2.

Chief Justice Marshall called the bank an instrument *of the United States.* 17 U.S. (4 Wheat.) at 432. That characterization is curious in light of the language of the bank's authorizing legislation. Section one of the authorizing act called for establishing the bank with $35,000,000 capital. The United States was to contribute 20% of the capital, while 80% was to come from "individuals, companies, or corporations." Act of April 10, 1816, ch. 44, 3 Stat. 266. The Bank's predominant private ownership calls into question the propriety of calling the Bank a government instrument. *See* Plous and Baker, *M'Culloch v. Maryland: Right Principle, Wrong Case,* 9 STAN. L. REV. 710, 712-13 (1957).

19. 17 U.S. (4 Wheat.) at 436-37. In *M'Culloch,* Chief Justice Marshall first concluded that the bank's authorizing legislation is part of the supreme law of the land. *See supra* note 17. Chief Justice Marshall then argued as follows. The Constitution and laws made under it are supreme. 17 U.S. (4 Wheat.) at 426. Consequently, when state laws conflict with national laws, the national law must prevail. *See id.* at 430-32. "The power to tax involves the power to destroy." *Id.* at 431. Therefore, permitting state taxes on the instruments of the federal government gives the states power to destroy those instruments. *Id.* at 431-432. Such a situation reverses the national supremacy that the Constitution expressly declares. *Id.* at 432. The people of one state cannot give that government power to tax something the representatives of all the people and all the states created. *Id.* Thus, the taxing power of the states cannot reach instruments of the national government. *Id.* at 436.

20. *See* Gillespie v. Oklahoma, 257 U.S. 501, 505 (1922) (Holmes, J.) (rule against taxing instrumentalities of the United States is absolute in form and strict in substance); Johnson v. Maryland, 254 U.S. 51, 55 (1920) (Holmes, J.) (no matter how reasonable, universal, or nondiscriminatory the levy, a state may not interfere with the United States by taxation); Home Ins. Co. v. New York, 134 U.S. 594, 598 (1890) (states may not impede, burden, or in any manner control the United States through taxation). *See generally* Tribe, *supra* note 1, at 701 ("M'Culloch thus announced the prophylactic per se rule that has followed ever since."); Comment, *supra* note 1 at 695.

Chief Justice Marshall formulated the *M'Culloch* problem as one of clashing sover-

ertheless, the opinion does not define "instrument."[21] Similarly, the opinion does not plainly declare whether the federal government and its instruments are immune from all taxes or only discriminatory or direct taxes.[22] Thus, *M'Culloch* fails to articulate the precise scope of constitutional federal immunity from state taxation.

In a subsequent case, *Weston v. City Council of Charleston,*[23] Chief Justice Marshall, writing for the Court, clearly indicates that the federal government and its instrumentalities are immune from *all* state taxes.[24] In *Weston,* the Court invalidated a state measure *consequentially* burdening a federal operation.[25] Employing an economic burden test,[26] the Court held that states may not impose a tax directly or

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eignties. *M'Culloch,* 17 U.S. (4 Wheat.) at 430. The Court decided *M'Culloch* in 1819, only 30 years after ratification of the Constitution. The emerging national government might well have needed protection from state encroachment. *See generally* G. GUNTHER, *supra* note 1, at 92-108. The absolute protection *M'Culloch* gave the national government is an anachronism today. Comment, *supra* note 1, at 716. Indeed, intergovernmental collaboration may be the essence of contemporary United States federalism. *See* D. ELAZAR, AMERICAN FEDERALISM: A VIEW FROM THE STATES 53-61 (1966). *See also supra* note 2 and authorities cited therein.

21. *M'Culloch* merely uses instrumentality interchangeably with means. *See, e.g.,* 17 U.S. (4 Wheat.) at 432.

22. Chief Justice Marshall indicated recognition of broad state taxing powers and infrequent application of federal immunity from state taxes when he concluded,

> This opinion does not deprive the States of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the State, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the State. But this is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional.

17 U.S. (4 Wheat.) at 436-37. Moreover, the tax involved in *M'Culloch* affected only the Bank of the United States. *M'Culloch,* therefore, arguably provides immunity only when a state discriminatorily taxes the United States or its instrumentalities. *See* First Ag. Nat'l Bank of Berkshire Cnty. v. State Tax Comm'n, 392 U.S. 339, 350 (1968) (Marshall, J., dissenting). *But cf.* Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449, 479 (1829) (Thompson, J., dissenting) (*M'Culloch* means states may not *directly* tax the United States). *Weston,* however, clearly indicates that the United States is exempt from all state taxes. *See infra* notes 23-27 and accompanying text.

23. 27 U.S. (2 Pet.) 449, 468 (1829) (Marshall, C.J.) (states may not tax in a way that directly of indirectly burdens the federal government; extent of burden is irrelevant).

24. *See id.* at 468.

25. *See id.* at 468-69.

26. *See id.* at 468. Under the economic burden test, courts find federal immunity

indirectly burdening the federal government to any extent.[27]

After *Weston,* the Court customarily found immunity when a tax in question placed an economic burden on the United States by raising the cost of a federal operation.[28] Thus, the economic burden test obviated the need to define "instrumentality." Despite its custom, the Court occasionally found an economic burden, but refused to find immunity.[29]

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if the United States ultimately pays the levy. *See, e.g.,* Johnson v. Williams, 254 U.S. 51, 55-56 (1920) (Holmes, J.).

27. *See Weston,* 27 U.S. (2 Pet.) at 468-69. Subsequent courts adopted the economic burden test to determine if a state tax consequentially burdens the federal government. *See, e.g.,* Panhandle Oil Co. v. Mississippi *ex rel.* Knox, 277 U.S. 218, 222 (1928) (Court invalidated state gross receipts tax on contractor selling gasoline to the federal government because the tax burdened the relationship between the contractor and the United States). The economic burden test indicates that a contractor is immune from a state tax whenever the tax increases a government operation's cost to the United States. *See id. See also* Tribe, *supra* note 1, at 706. Under a cost-plus contract, for example, the economic burden of a tax falls on the government as the ultimate payor because the taxes are reimbursable expenses. Thus, cost-plus federal contractors would be exempt from state taxes. The economic burden test indicates immunity for virtually anyone involved in an economic relationship with the United States. *See, e.g.,* Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842) (barring state tax on a federal officer). *See also* Tribe, *supra* note 1, at 703.

28. Tribe, *supra* note 1, at 706. *See* James v. Dravo Contracting Co., 302 U.S. 134, 161-70 (Roberts, J., dissenting) and cases cited therein. *See also* Powell, *An Imaginary Judicial Opinion,* 44 HARV. L. REV. 889 (1931) (reviewing early cases involving federal immunity from state taxes).

The doctrine of federal immunity from state taxation reached its greatest scope between 1870 and 1930. *See* G. GUNTHER, *supra* note 1, at 359. Collector v. Day, 78 U.S. (11 Wall.) 113 (1871) made tax immunity reciprocal. In that case, the Court held a state official exempt from federal income tax. *See id.* The *M'Culloch* Court had rejected the suggestion that state and federal taxing powers are equal and, therefore, subject to the same limitations. G. GUNTHER, *supra* note 1, at 359. *M'Culloch* indicated that the federal government may tax state institutions as long as the levies are uniform. *See* 17 U.S. (4 Wall.) at 435-36. The Court said federal sovereignty comes from all the people of the United States. *Id.* Thus, the federal government taxes its constituents when it taxes a state institution. *See id.* A state's sovereignty comes only from the people of that state. *Id.* Thus, the state government can act only on the people of that state. *Id.*

29. *See* Powell, *Waning, supra* note 1, at 634-35. In Trinityfarm Constr. Co. v. Grosjean, 291 U.S. 466 (1934), the court found an economic burden on the United States, yet refused to find immunity. *Trinityfarm* was a contractor constructing levees for the United States. *Trinityfarm* sought exemption from Louisiana's gasoline tax. The Court determined that the contractor's payment did not place a direct or immediate burden on the United States. *Id.* at 472. At most, the government's burden was consequential and remote. *Id.* The Court, therefore, concluded that the contractor's claim of immunity lacked foundation. *Id.* The Court also stated that independent contractors are not government instrumentalities. *Id.* at 472. Thus, *Trinityfarm* per-

James v. Dravo Contracting Co.[30] involved an independent contractor who had agreed to build locks and dams for the United States on navigable streams in West Virginia. The state levied its gross receipts tax on income Dravo had received from the United States. Dravo claimed federal immunity and sought to enjoin collection of the tax. The Supreme Court determined that Dravo was an independent contractor rather than a government instrumentality.[31] The Court rejected Dravo's economic burden argument.[32] Therefore, the Court found the contractor to be outside the reach of constitutional federal immunity.[33]

Justice Roberts wrote a strong dissent in *Dravo,* highlighting the Court's break with a century of economic burden test precedents and arguing that the Court misconstrued the *M'Culloch* doctrine.[34] Justice Roberts emphasized that the *M'Culloch* doctrine rests on the federal government's constitutional supremacy over the states.[35] He suggested that the Court's rejection of the economic burden test impairs the United States' ability to perform its duties by preventing the federal government from freely hiring agents when it would be expe-

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mits the inference that federal immunity protects only instrumentalities from state taxes and expressly eliminates independent contractors from the ranks of federal instrumentalities.

30. 302 U.S. 134 (1937).

31. *Id.* at 160.

32. *Id.* at 149.

33. *See id.* at 152-57. The Court set *Dravo* apart from cases in which it had found immunity. The Court noted that some cases in which it had found immunity involved taxes on the government, its property, or its officers, but that was not true in *Dravo. Id.* at 149. The Court also had found immunity in cases involving discriminatory taxes, but West Virginia's tax was nondiscriminatory. *Id.* at 149-51. The Court had found immunity in cases involving a state tax of a government contract. West Virginia did not tax *Dravo*'s contract with the United States. *Id.* at 149-50. In still other cases, acts of Congress had been involved. That was not the case in *Dravo. Id.* at 150-51. The Court deemed other pre-*Dravo* immunity cases limited to their particular facts. *Id.* at 151.

34. *See* 302 U.S. at 161-186 (Roberts, J., dissenting). Justice Roberts contended that the *Dravo* Court overruled, *subsilentio,* more than 100 years of economic burden test precedents. 302 U.S. at 161 (Roberts, J. dissenting). Indeed, it appears that the *Dravo* Court could have reached its conclusion based on Trinityfarm Constr. Co. v. Grosjean, 291 U.S. 466 (1934). *See supra* note 29 for a discussion of *Trinityfarm.* Mere reliance upon *Trinityfarm* would not have changed the course of the law. Thus, the Court seemingly intended to overrule the long line of cases following Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829). *See supra* notes 23-29 and accompanying text for a discussion of *Weston* and cases following it.

35. 302 U.S. at 171-72 (Roberts, J., dissenting).

dient to do so.[36] Justice Roberts concluded that neither policy[37] nor precedent[38] supported West Virginia's levy on contractors with the federal government.

The line of cases following *Dravo* created the legal incidence test for constitutional federal immunity from state taxation. The legal incidence test requires courts to determine which party the state legisla-

36. *Id.* at 163.

37 *See id.* at 161-62. Justice Roberts argued that the Court's decision jeopardized two public policies: federal supremacy and predictable application of the law. *Id.* Justice Roberts failed to consider relevant political and economic environments. The Court decided M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) very soon after adoption of the Constitution, while the debilitating effects of state supremacy under the Articles of Confederation were fresh. Protecting the national government from state encroachment was a paramount concern of the Constitution's drafters. *See* THE FEDERALIST No. 46 (J. Madison). The same concern influenced Chief Justice Marshall and his major opinions reflect that concern. In addition to *M'Culloch, see, e.g.,* Gibbons v. Ogden, 22 U.S. (7 Wheat.) 1 (1824) (defining federal commerce power). *See generally* G. GUNTHER, *supra* note 1, at 92-106.

Passage of the 16th Amendment in 1913, permitting federal taxation of individual income without apportionment among the states, assured the national government's security vis-a-vis the states because the federal government quickly became the repository of the vast majority of the nation's tax revenues. *See* ELAZAR, *supra* note 20, at 62. The federal government responded to the depression of the 1930's by creating numerous national programs requiring financial and administrative centralization. R. LEACH, *supra* note 2, at 197. Centralization further entrenched the federal government and further established federal dominance in the political sphere.

In 1937, the same year it decided *Dravo,* Supreme Court decisions facilitated federal forays into economic regulation and other traditional state areas. In the leading case of National Labor Relations Bd. v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937), the Court granted an injunction prohibiting Jones & Laughlin from firing employees for unionizing activity. In upholding the National Labor Relations Act, *Jones & Laughlin* allows federal regulation of intrastate industry if it affects commerce among the states or with foreign nations. In Steward Machine Co. v. Davis, the Court upheld the federal government's power to encourage state action through tax credits. 301 U.S. 548 (1937). Both *Jones & Laughlin* and *Steward Machine* preceded *Dravo.* Thus, before the court opened the door to state taxation of contractors performing federal functions, it had allowed the federal government to take an active role in areas previously reserved to the states.

With the federal government secured against state domination, the historical reason for protecting the United States from state taxation disappeared. While there has always been some cooperation between the national and state governments, ELAZAR, *supra* note 20, at 54, the scope and extent of intergovernmental cooperation has continually increased. *Id.* at 53. The problems facing the nation in 1937 certainly required cooperative federalism, not *M'Culloch*'s theory of clashing sovereignties.

38. Justice Roberts attacked the Court's rationale by impeaching its precedents. *See* 302 U.S. at 172-75.

ture intended to tax.[39] Immunity applies if the legislature intends to tax the United States or its instrumentality.[40] The Court did not articulate a test for determining when a nongovernmental entity is a federal instrumentality.[41] Nevertheless, the requirements are stringent.[42] Absent a state tax directly on the United States,[43] constitutional federal immunity from state taxation is usually inappropriate under the legal incidence test.

Soon after *Dravo,* the Supreme Court applied the legal incidence test in *Alabama v. King & Boozer.*[44] In *King & Boozer,* a lumber dealer sued the state to enjoin collection of sales tax on lumber sold to a contractor building an Army base under a cost-plus contract.[45] Pursuant to the contract, the United States held title to any goods the contractor purchased. Further, the federal government maintained extensive control over all purchases. The United States ultimately paid for the goods because the government reimbursed the contractor

39. *See* Comment, *supra* note 1, at 702. While the economic burden of a tax does not determine legal incidence, it may indicate legislative intent. *See id.* at 703.

40. *See id.*

41. *See* Department of Employment v. United States, 385 U.S. 355, 358-59 (1966) (there is no simple test for instrumentality, but factors to look for include federal charter, government supervision, government appointment of officers, and statutory responsibility) (American Red Cross is an instrumentality). *But cf.* Livingston v. United States, 364 U.S. 281 (1980) (private, for-profit corporation voluntarily designed, built, and operated a defense plant without recompense granted tax immunity as federal instrumentality), *aff'g per curiam* 179 F. Supp. 9 (E.D. S.C. 1959).

42. *See* Department of Employment v. United States, 385 U.S. 355, 359-60 (1966) (instrumentality must be an arm of the government); City of Detroit v. Murray Corp. of America, 355 U.S. 489, 503 (1958) (instrumentality must stand in the government's shoes); United States v. Township of Muskegon, 355 U.S. 484, 486 (1958) (instrumentality must be so assimilated by government as to become one of its constituent parts; contractor is not an instrumentality); Standard Oil Co. v. Johnson, 316 U.S. 481, 485 (1942) (instrumentality is an arm of the government). *Cf.* United States v. Boyd, 378 U.S. 39, 48 (1964) (suggests that profit-making contractor cannot be government instrumentality).

43. *See* Mayo v. United States, 319 U.S. 441 (1943) (The Court found a Florida fee for inspecting fertilizer owned by the United States to be a tax on the federal government and held that the supremacy clause freed the United States from paying the fee.) *See also* United States v. County of Fresno, 429 U.S. 452, 460 (1977) ("So long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory. . .").

44. 314 U.S. 1 (1941).

45. *See id.* at 6-7. The tax statute made the seller liable for a percentage of sales receipts, designating the seller the taxpayer. *Id.* Nevertheless, the statute also required the seller to collect the amount owed on each purchase from the purchaser. *Id.* Thus, the tax's legal incidence was on the purchaser. *Id.* at 7.

for all purchases.[46] The Supreme Court upheld the levy in *King & Boozer,* finding that the legislature had intended to tax the contractor-purchaser and the contractor was not an instrumentality of the United States.[47] The Court expressly rejected economic burden arguments.[48] Dictum implied that the legal incidence of a tax shifts to the United States if a contract's language renders a contractor a federal agent.[49]

In *Kern-Limerick, Inc. v. Scurlock,*[50] the Court held a contractor a federal purchasing agent and, therefore, exempt from a state sales tax. In *Kern-Limerick,* a tractor dealer sued Arkansas' tax commissioner, seeking refund of sales tax paid under protest.[51] A contractor building an ammunition dump for the Navy had purchased two tractors from Kern-Limerick for the construction.[52] An Arkansas statute required the seller to pay a tax on the sale and to collect the levy from the purchaser.[53] The Court distinguished *Kern-Limerick* from *King & Boozer* on the basis of contractual language expressly making the *Kern-Limerick* contractor a government purchasing agent.[54] The Court held that the contract had shifted the tax's legal incidence from the contractor to the United States.[55]

Kern-Limerick's emphasis on contractual language raised form above substance.[56] The Court discounted the substantive similarity of *Kern-Limerick* and *King & Boozer,* including the fact that in both cases, the legislature had intended the contractors to pay the tax.[57]

46. 314 U.S. at 10, 13.

47 *See id.* at 14.

48 *See id.* at 16.

49. *Id.* at 12.

50. 347 U.S. 110 (1954).

51. *Id.* at 113.

52. *Id.* at 111.

53. *Id.* at 111-12.

54. Comment, *supra* note 1, at 704. *See* 347 U.S. at 112 n.2. For a discussion of *King & Boozer,* see *supra* note 57-64 and accompanying text.

55. *Kern-Limerick,* 347 U.S. at 120-21.

56 *See* Tribe, *supra* note 1, at 710; Comment, *supra* note 1, at 704. Indeed, the *Kern-Limerick* Court stated that under its holding, "the form of contracts . . . may determine the effect of state taxation on federal agencies." 347 U.S. at 122-23.

57. *See Kern-Limerick,* 347 U.S. at 118-19. Both *Kern-Limerick* and *King & Boozer* involved a contractor doing construction work for the United States military. 347 U.S. at 110; *King & Boozer,* 314 U.S. at 1. The contractor in each case had a cost-plus contract so the United States reimbursed all construction costs. In both cases, the contractors purchased goods subject to state sales tax for use in the construction. The

The Court's assertion that the *Kern-Limerick* contract shifted the tax's legal incidence is unconvincing. The legal incidence of a tax falls on the party the legislature intended to tax.[58] A contract cannot change the legislature's intent. The *Kern-Limerick* Court, therefore, effectively ignored the true legal incidence of Arkansas' sales tax. The Court simply found immunity because the tax's economic burden fell on the United States.[59]

The Court's *Kern-Limerick* opinion implies that agents of the federal government are constitutionally immune from state taxes.[60] In *United States v. Boyd,*[61] the Court returned to its pre-*Kern-Limerick* application of the legal incidence test to find that federal contractors lacked constitutional immunity from Arkansas' use tax. In *Boyd,* the Atomic Energy Commission sued Tennessee to recover use taxes the contractors had paid.[62] The contractors performed management and construction services on a cost-plus-fee basis at a federally owned atomic facility.[63] The contractors paid for purchases with advanced federal funds.[64] Only the United States had an ownership interest in goods the contractors bought.[65] The contractors managed their daily affairs while the Commission retained the right to supervise them directly.[66] Applying the legal incidence test, the Court found that the

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sales tax was a reimbursable cost under both contracts. Thus, in both cases, the ultimate burden of the tax fell on the United States. In both cases, however, the state intended to tax the contractor, not the federal government. *See supra* notes 44-49 and accompanying text discussing *Alabama v. King & Boozer;* notes 50-59 and accompanying text discussing *Kern-Limerick v. Scurlock.*

58. *See supra* notes 39-43 and accompanying text discussing the legal incidence test.

59. *See* Tribe, *supra* note 2, at 710.

60. *See* 347 U.S. at 112 n.2.

61. 378 U.S. 39 (1964).

62. *Id.* at 43. Plaintiffs also sought recovery of sales taxes the contractors had paid. The Court did not consider the issue because the Supreme Court of Tennessee, relying on *Kern-Limerick,* found the contractors to be federal purchasing agents. *Id.* at 43 n.5. *See supra* notes 65-71 and accompanying text discussing Kern-Limerick v. Scurlock, 347 U.S. 110 (1954). Thus, the sales tax fell on the United States and the federal immunity doctrine barred the levy. Neither party sought review of Tennessee's sales tax decision. *Id.*

63. *Boyd,* 378 U.S. at 41, 43.

64. *See id.* at 41, 43. *See also supra* note 8 and accompanying text discussing advanced funding.

65. *See* 378 U.S. at 41, 42-43.

66. *Id.* at 42.

state had taxed the contractors, not the federal government.[67] The Court equated federal agents with federal instrumentalities.[68] The Court next rejected arguments that the contractors were federal agents, declaring that contractors profiting from their relationship with the government cannot be federal instrumentalities.[69] Thus, the Court found that the contractors were not constitutionally immune from Tennessee's use tax.[70]

To summarize, the preceding review of Supreme Court decisions suggests lack of a principled basis for applying the *M'Culloch* doctrine. For more than one hundred years, the Court employed an economic burden test to find immunity if the United States ultimately paid a tax.[71] Nevertheless, the Court occasionally found an economic burden without also finding immunity.[72] In *James v. Dravo Contracting Co.*, the Court ignored over one hundred years of authority for liberally applying the doctrine.[73] Supreme Court cases following *Dravo* enunciated a legal incidence test for evaluating contractors' claims of constitutional immunity from state taxes.[74] In *Kern-Limerick, Inc. v. Scurlock,*[75] however, the Court arguably applied an economic burden test.[76] The Court employed the legal incidence test in subsequent cases.[77] *United States v. New Mexico*[78] gave

67. *See id.* at 44.

68. *See id.* at 46-47, 48.

69. *See id.* at 48.

70. *See id.*

71. *See* Tribe, *supra* note 1, at 706 (Employing the economic burden test, "immunity was almost always implied when the state tax would otherwise have increased the cost of the government's operations."). *See also supra* notes 14-29 and accompanying text discussing the *M'Culloch* doctrine's pre-1937 history.

72. *See, e.g.*, Trinityfarm Constr. Co. v. Grosjean, 291 U.S. 466 (1934) (discussed *supra*, note 29). *See also* Powell, *Waning, supra* note 1, at 634-35 and cases cited therein.

73. *See* 302 U.S. 134, 161 (1937) (Roberts, J., dissenting).

74. *See supra* notes 39-43 and accompanying text discussing the legal incidence test.

75. *See supra* notes 50-59 and accompanying text discussing Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954).

76. *See* Tribe, *supra* note 1, at 710 ("An economic burden test might appear different from a formal one, but would likewise delegate discretionary authority . . . to federal . . . agencies, enabling them to immunize third parties . . . by contracting to absorb the costs of the tax."). *See also* Comment, *supra* note 1, at 704 ("*Kern-Limerick* . . . allows the government . . . to restore to private parties the very immunity withdrawn by *King & Boozer.*").

77. *See, e.g.*, City of Detroit v. Murray Corp. of America, 355 U.S. 489 (1958)

the Court an opportunity to clarify the law regarding federal contractors' constitutional immunity from state taxes.

In *United States v. New Mexico,* the Court first reviewed the basis, history, and purpose of the *M'Culloch* doctrine, concluding that confusing precedents necessitate a return to the doctrine's underlying constitutional principle.[79] The Court recognized the doctrine's basis in the supremacy clause, but suggested that *M'Culloch* itself permits extensive state taxing powers.[80] While noting that *M'Culloch* arguably exempts the United States from only discriminatory state taxes, the Court recognized that the Supreme Court has never questioned the propriety of absolute federal immunity from state taxes.[81] Relying on *M'Culloch,* the Court determined that the constitutional immunity doctrine's purpose is to prevent conflicts between sovereigns by barring states from laying demands *directly* on the federal government.[82] Thus, the Court rejected Chief Justice Marshall's extension of *M'Culloch* to encompass consequential state burdens on the federal government.[83] The Court concluded that this view retains the doctrine's historically absolute nature and achieves the doctrine's purpose of avoiding clashing sovereignty, while limiting the doc-

(upholding state tax on private use of federal property); United States v. Township of Muskegon, 355 U.S. 484 (1958) (upholding state tax on private use of federal property); United States v. City of Detroit, 355 U.S. 466 (1958) (upholding state tax on private use of federal property); United States v. Boyd, 378 U.S. 39 (1964) (upholding state use tax on federal contractor). *See also supra* notes 62-70 and accompanying text for a discussion of *Boyd. Kern-Limerick,* however, remains good law.

78. 455 U.S. 720 (1982).

79. *See id.* at 733.

80. *See id.*

81. *See id.* at 735-36. It is generally accepted that a state may not impose a tax that discriminates against the United States. *See, e.g.,* First Ag. Nat'l Bank of Berkshire Cnty. v. State Tax Comm'n, 392 U.S. 339 (1968) (Marshall, J., dissenting); United States v. Montana, 437 F. Supp. 354 (D. Mont. 1977) *rev'd on other grounds,* 440 U.S. 147 (1978); Comment, *supra* note 2, at 706. Thus, a state tax affecting a federal operation must equally affect state operations. *See, e.g.,* Moses Lake Homes, Inc. v. Grant County, 365 U.S. 744 (1961); Phillips Chem. Co. v. Dumas Ind. School Dist., 361 U.S. 376 (1959). Nevertheless, a state may differentiate between entities when assigning the *legal incidence* of a tax as long as the resulting *economic burdens* are equal. Washington v. United States, 103 S. Ct. 1344, 1349 (1983) (5-4 decision upholding a state sales tax on federal contractors but no other contractors because the state levied a corresponding tax on the owners of other construction projects).

82. 455 U.S. at 735-36.

83. *See supra* notes 23-27 and accompanying text discussing Chief Justice Marshall's explanation of the *M'Culloch* doctrine in Westin v. City of Charleston, 27 U.S. (2 Pet.) 449 (1829).

trine's restraint of state taxing power.[84]

The *United States v. New Mexico* Court next adopted the legal incidence test for contractors' claims of constitutional federal immunity.[85] The Court indicated that only the legal burden of a tax, not its economic burden, is germane to an inquiry concerning constitutional immunity.[86] The government conceded that the contractors bore the legal incidence of the taxes and the Court agreed without discussion.[87]

The United States contended that the *Kern-Limerick* rule exempted the contractors from state taxation because they were purchasing agents acting on the government's behalf.[88] In the final step of its analysis, therefore, the Court considered whether the contractors were immune from state taxation because they were federal agents.

The Court recognized that entities can be sufficiently intertwined with the federal government to be indistinguishable from it.[89] Like the United States itself, such entities are exempt from state taxes.[90] The Court asserted, however, that finding a contractor constitutionally immune from state taxation requires more than a traditional principal-agent relationship.[91] The contractor "must actually 'stand in the Government's shoes.' "[92] The test is whether the contractors

84. 455 U.S. at 735-36. The Court's opinion recognizes the historical necessity of absolute federal immunity from state taxes. *Id.* at 735. Nevertheless, the Court indicates that the doctrine has only symbolic importance today. *Id.* at 735.

85. 455 U.S. at 735 n.11 (The "economic—as opposed to the legal—incidence" of a state tax is not "relevant" to federal tax immunity.).

86. *See id.*

87. *See id.* at 738.

88. Brief for the United States at 20, United States v. New Mexico, 455 U.S. 720 (1982). The government contended that the power to commit federal funds is the essence of a purchasing agent. *See id.* That is the view expressed in United States v. Forst, 569 F.2d 811 (9th Cir. 1978) ("key factor" was whether credit of the United States or the contractor was bound by the purchase agreements). Similarly, the district court found that position compelling and agreed that the advanced funding procedure gave the contractors power to pledge federal funds. United States v. New Mexico, 455 F. Supp. 993, 996 (D. N.M. 1978). That power, the court argued, combined with the government's control over the contractors' purchases, made the contractors federal procurement agents entitled to immunity from state taxes. *See id.* at 997.

89. United States v. New Mexico, 455 U.S. at 735.

90. *Id.*

91. *Id.* at 736.

92. *Id.* (quoting City of Detroit v. Murray Corp., 355 U.S. 489, 503 (1958)). An

were independent of the United States.[93] If the Court finds independence, the contractor is not a federal instrumentality. The Court indicated that this requirement would prevent contract language from determining how the Constitution applies to a contractor.[94]

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agency standard is less strict than the instrumentality standard the Court has adopted. The RESTATEMENT (SECOND) OF AGENCY defines agency, principal, and agent as follows:

1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.

2) The one for whom action is to be taken is the principal.

3) The one who is to act is the agent.

RESTATEMENT (SECOND) OF AGENCY § 1 (1957). The RESTATEMENT defines master, servant, and independent contractor as follows:

1) A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.

2) A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master.

3) An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking. He may or may not be an agent.

Id. § 2. Thus, an independent contractor can be the United States' agent. Based on an agent-principal relationship, the Court found a federal contractor immune from state sales tax in Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954). The Court has also indicated that it would have found immunity if there had been an agent-principal relationship. *See, e.g.,* Alabama v. King & Boozer, 314 U.S. 1, 13 (1941). The contractor cannot be a servant while maintaining its independence, its freedom from the master's right to control. Thus, a master-servant relationship is closer and presents a stricter standard than a principal-agent relationship. The Court has indicated in dicta that a master-servant relationship between the United States and a contractor would place the contractor within the umbrella of federal immunity from state taxes. *See, e.g.,* United States v. Township of Muskegon, 355 U.S. 484, 486 (1958). In other cases, the court has rejected immunity claims based on such a relationship. *See, e.g.,* United States v. Boyd, 378 U.S. 39, 42 (1964) (The Court did not find immunity despite government's retention and exercise of "the right to control, direct, and supervise the performance of the work.").

The instrumentality standard the Court has adopted requires more than a principal-agent or master-servant relationship. Indeed, it appears to require an absolute identity of interests between the United States and the taxpayer claiming immunity. *See* United States v. New Mexico, 455 U.S. 720, 740 (1982) ("The congruence of professional interests between the contractors and the Federal Government is not complete . . . "). *See also supra* notes 41, 42 discussing the Court's notion of instrumentality.

93. *See* 455 U.S. at 738.

94. *See id.* at 737.

The Court relied on that *United States v. Boyd* to resolve the independence issue.[95] The *Boyd* Court rejected the United States' claim of federal contractors' constitutional immunity from Tennessee's use tax because the contractors had been independent of the United States, rather than federal instrumentalities.[96] The Court based its finding of independence on the contractors' pursuit of private profits.[97] In *United States v. New Mexico,* the Court found that the government contracts had served the contractors' private interests.[98] Thus, the Court concluded, consistent with *Boyd,* that the contractors had been independent of the United States.[99]

After finding the contractors independent of the United States, the Court easily disposed of the claims of constitutional immunity from New Mexico's use tax and gross receipts tax. The Court held, relying on *Boyd,* that the contractors in *United States v. New Mexico* are not constitutionally immune from New Mexico's use tax.[100] The Court relied on *James v. Dravo Contracting Co.* to dispose of the claim of constitutional immunity from gross receipts tax.[101] The *Dravo* Court had found an independent contractor insufficiently connected with the United States to share immunity from a state gross receipts tax.[102] Thus, the *United States v. New Mexico* Court held, consistently with *Dravo,* that New Mexico's gross receipts tax is a constitutional levy on an independent contractor.[103]

95. *See id. See also supra* notes 61-70 and accompanying text for a discussion of United States v. Boyd, 378 U.S. 39 (1964).

96. 378 U.S. at 48.

97. *See id.*

98 *See* 455 U.S. at 739.

99. *See id.* The Court found that the contractors were not constituent parts of the federal government. *See id.* If the contractors were not part of the government, they must be independent of the government. Thus, finding that federal contractors are not constituent parts of the government accords with *Boyd*'s conclusion that contractors doing business with the United States are independent of the government.

100. *See id.* at 740-41. As in *Boyd,* the Court found that the contractors in *United States v. New Mexico* profited from their relationship with the federal government. 455 U.S. at 740. Given that finding, the Court, as in *Boyd,* concluded that the contractors were independent of the United States. *See* 378 U.S. at 48. *Boyd*'s logic demanded, therefore, that *United States v. New Mexico* uphold New Mexico's use tax levy on the contractors. *See id.*

101 *See id.* at 741. *See supra* notes 30-38 and accompanying text for a discussion of James v. Dravo Contracting Co., 302 U.S. 134 (1937).

102 *See* 302 U.S. at 157 (applying to *Dravo* the reasoning of Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1926)).

103. *See* 455 U.S. at 741.

The Court next addressed the sales tax question. The Court indicated that a purchasing agent relationship between the federal government and a contractor exists when a sale to the contractor is a real and symbolic sale to the United States.[104] A contractor may be a purchasing agent without being an instrumentality of the federal government.[105] A federal purchasing agent is constitutionally exempt from state sales tax.[106] Thus, the Court reaffirms *Kern-Limerick*'s holding,[107] but the Court interprets *Kern-Limerick* as merely barring state taxes legally incident on the United States.[108]

The Court factually distinguished *United States v. New Mexico* from *Kern-Limerick.*[109] The Court found that the difference caused

104. *See Id.*

105. *See id.* The Court stated that a federal purchasing agent "can be so closely associated with the Government, and so lack an independent role in the purchase, as to make the sale . . . a sale to the United States, even though the purchasing agent has not otherwise been incorporated into the Government." *Id.* The Court noted that such had been the Court's determination in Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954). *See id.* The Court further noted that *Kern-Limerick* had concluded that "a sale to the contractor was in effect a sale to the United States, and therefore not a proper subject for the Arkansas sales tax." *Id.* The Court went on to find the *Kern-Limerick* rule inapplicable to *United States v. New Mexico.* The Court's indication that *Kern-Limerick* applies to any federal purchasing agent demonstrates the current Court's adoption of *Kern-Limerick.* The Court's detailed analysis of *Kern-Limerick* and its efforts to distinguish *Kern-Limerick* from *United States v. New Mexico* further demonstrate that *Kern-Limerick* remains good law. *See infra* notes 122, 123 and accompanying text concerning the Court's distinction between *Kern-Limerick* and *United States v. New Mexico.*

106. *See* 455 U.S. at 741-742.

107. *See id.* at 742. The Court's declaration that federal immunity must be based on more than traditional agency concepts is incongruous with its failure to overrule *Kern-Limerick. Kern-Limerick* found immunity on the basis of a traditional agency concept. *See supra* note 92 for a discussion of agency concepts. It makes no sense to expressly require more than an agent-principal relationship for immunity while retaining an agency-based precedent, but that is the effect of *United States v. New-Mexico. See* 455 U.S. at 736, 742.

108. *See id.* at 1386 (quoting United States v. County of Fresno, 429 U.S. 699, 459 n.7 (1977)). The Court apparently ratified *Kern-Limerick. See supra* note 105. The Court then stated that *Kern-Limerick* " 'stands only for the proposition that the State may not impose a tax the legal incidence of which falls on the Federal Government.' " 455 U.S. at 742 (quoting United States v. County of Fresno, 429 U.S. 452, 459 n.7 (1977)). Thus, the Court downplayed the importance of *Kern-Limerick*'s contract language. *See id. See supra* notes 50-59 for a discussion of *Kern-Limerick.* Nevertheless, *Kern-Limerick*'s primary message is that contract language can confer federal immunity. *See* Tribe, *supra* note 1, at 710. The Court only confuses by failing to overrule *Kern-Limerick* while trying to circumvent the import of the case.

109. *United States v. New Mexico,* 455 U.S. at 743. The Court found: 1) The

the contractors in *United States v. New Mexico* to fall short of purchasing agent status.[110] Thus, the Court held that the contractors in *United States v. New Mexico* do not qualify for constitutional immunity from state sales tax.[111]

United States v. New Mexico is noteworthy for its reevaluation of the *M'Culloch* doctrine.[112] The Court attempts to balance the United States' interests with state interests in light of the history of the immunity doctrine.[113] Thus, the Court protects federal supremacy by retaining absolute immunity from state taxes for the United States and its instrumentalities. At the same time, the Court's restrictive approach to claims that a contractor is a federal instrumentality permits broad state taxing powers. The Court's refusal to read *M'Culloch* as proclaiming immunity only from discriminatory state taxes recognized 160 years of the doctrine's development.[114] Nevertheless, the Court virtually ignores federal immunity cases between *M'Culloch* and *Dravo.* Thus, the Court clearly signals its repudiation of an expansive interpretation of the doctrine.

United States v. New Mexico is also noteworthy for limiting *Kern-Limerick's* agency exception to the legal incidence text for federal immunity from state taxes.[115] The Court expressly states that traditional notions of agency do not justify constitutional immunity.[116] The Court only considers the alleged agent-principal relationship

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New Mexican contractors purchased in their own names, while *Kern-Limerick*'s contractors purchased in the name of the United States. 2) New Mexico's vendors were not informed of the United States' interest in the contractors' purchases, while *Kern-Limerick*'s contractors clearly expressed that interest to vendors. *But see supra* note 14 (vendors arguably had notice). 3) The government refuses to formally designate the New Mexican contractors as agents, while it contractually named *Kern-Limerick*'s contractors as agents. 4) The New Mexican contractors could purchase without advance approval, *Kern-Limerick*'s contractors could not. *See* United States v. New Mexico, 455 U.S. at 743.

110. *See* 455 U.S. at 742-43.

111. *See id.*

112. *See id.* at 730-738. *See supra* notes 79-84 and accompanying text for a discussion of the Court's reevaluation of the *M'Culloch* doctrine.

113. *See* 455 U.S. at 735-36.

114. *See id.* at 733.

115. *See supra* notes 107-111 and accompanying text for a discussion of the Court's treatment of *Kern-Limerick. See also supra* notes 50-55 and accompanying text for a general discussion of *Kern-Limerick.*

116. 455 U.S. at 736.

with respect to sales tax levies on purchasing agents.[117] Even then, the Court does not find immunity despite substantial similarity between *Kern-Limerick* and *United States v. New Mexico.*[118] Thus, it appears that an agency theory supports a claim of constitutional immunity only under the facts of *Kern-Limerick.*

Finally, *United States v. New Mexico* is noteworthy because it states that a contractor benefiting from its relationship with the United States cannot be a federal instrumentality. The test asks if a body receives *any* material benefit from its relationship with the United States. If so, the body is independent of the federal government.[119] If independent of the United States, the body is not a federal instrumentality.[120] Conversely, a body performing a task for the United States can be a federal instrumentality only if it receives no benefit from its relationship to the government. While the Court did not state that all bodies performing tasks for the United States without benefit are federal instrumentalities, such a rule is probable.[121] The Court's definition makes it very unlikely that any contractor working for the federal government can qualify as a federal instrumentality. The test and definition are long awaited additions to the law.

United States v. New Mexico warrants criticism because its failure to overrule *Kern-Limerick*[122] maintains "wooden formalism" in the

117. *See id.* at 738-44.

118. *See id.* at 742-43. The Court distinguished Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954) from United States v. New Mexico, 455 U.S. 720 (1982). *See also supra* note 109 for a discussion of the Court's contrast of *New Mexico* and *Kern-Limerick.* Nevertheless, the cases are similar. Both cases involved contractors doing business for the United States. In both cases the government retained the right to control the contractors' actions. Both cases involved state sales taxes levied on purchases for the United States. The federal government ultimately paid the tax in both cases. In both cases the contractors made purchases with federal funds. In both cases the contractors benefited from their relationship with the federal government. *See* Brief for the United States at 26-29.

119. *See* United States v. New Mexico, 455 U.S. at 720.

120. *See id.* at 740-41.

121. *See id.* at 740 n.13. There, the Court discusses United States v. Livingston, 179 F. Supp. 9 (E.D. S.C. 1959) *aff'd per curiam* 364 U.S. 281 (1960). The Court emphasizes the "extraordinary" nature of the *Livingston* contract, the contractor's contribution to the defense effort, the contractor's action without hope of gain, and the fact that the contractor received no benefit from his effort. *See* 455 U.S. at 740 n.13.

122. *See* Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954). *See also supra* notes 50-59 and accompanying text for a discussion of *Kern-Limerick.*

law.[123] The facts and effects of *Kern-Limerick* and *United States v. New Mexico* are substantially identical. In both cases, private contractors performed work for the United States. The contractors benefitted from their relationships with the United States. The contractors bought goods with government funds. Only the United States had an ownership interest in the goods. In both cases, the states intended to tax the contractors. While all the contracts placed the economic burden of contractors' taxes on the United States, only the *Kern-Limerick* contracts expressly made the contractors purchasing agents for the United States. Only contractual language differentiates *Kern-Limerick* from *United States v. New Mexico.*

In *United States v. New Mexico,* the Court declares that a constitutional immunity cannot rest on such technical considerations as the government's advance funding system.[124] If it could, the Court cautions, an administrator could change the constitutional line by changing contract language.[125] Despite that warning, the Court's failure to overrule *Kern-Limerick* permits administrators to draw the constitutional line by designating a contractor a purchasing agent. The Court, therefore, misses an opportunity to eliminate a legal loophole that raises form above substance.

The result in *United States v. New Mexico* advances the substantial state interest in financing state government. The Court clearly signals its intention to scrutinize closely all claims of constitutional immunity from state taxation for federal contractors. While federal purchasing agents will remain immune from state sales taxes, the Court expressly states that traditional notions of agency do not justify constitutional immunity in other situations. Furthermore, the Court indicates that it will find contractors to be purchasing agents only in narrowly circumscribed circumstances. The Court also affirms its lack of concern for the federal government's economic burden resulting from federal contractors' state taxes. By severly limiting the availability of constitutional immunity for federal agents while discounting a state tax's economic burden on the federal government, the Court demonstrates its intention to protect state tax bases at the federal government's expense. Parties desiring immunity from state

123. *See supra* note 56.

124. 455 U.S. at 737.

125. *See id.*

taxes for federal contractors should petition Congress, not the Court.[126]

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126. *See id.* at 744. In Carson v. Roane-Anderson Co., 342 U.S. 232 (1952) the Supreme Court held that the Atomic Energy Act of 1946, Pub. L. 262, 67 Stat. 575, conferred on Atomic Energy Commission (AEC) contractors immunity from state taxation. 342 U.S. at 236. Congress, apparently responding to the Court's construction, amended the Act to put AEC contractors on equal footing with other federal contractors in regard to state taxes. *See* S. Rep. No. 694, 83d Cong., 1st Sess., 3 (1953). The Senate report on the amendment indicates the drafters' belief that "constitutional immunity does not extend to . . . contractors of the Federal Government." *See id.* at 2. Nevertheless, there is no doubt that Congress may grant statutory immunity from state taxes. *See* First Ag. Nat'l Bank of Berkshire Cnty. v. State Tax Comm'n, 392 U.S. 339 (1968) (statute barred a state tax on a national bank). Congress' action following the Court's *Roane-Anderson* decision, however, suggests that Congress is not likely to provide immunity from state taxes for all contractors doing business with the United States.