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Constitutional Law - Governmental Immunity - Immunity of Agent of Federal Government to State Taxation

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CONSTITUTIONAL LAW — GOVERNMENTAL IMMUNITY — IMMUNITY OF AGENT OF FEDERAL GOVERNMENT TO STATE TAXATION — E. I. du Pont de Nemours and Company contracted with the Atomic Energy Commission to construct and operate the Savannah River Project for development of the hydrogen bomb for a fee of one dollar. Under the contract du Pont was to purchase all materials and supplies with funds furnished by the United

States, title to vest in the government immediately when it passed from the vendor. South Carolina attempted to apply its sales and use taxes to these purchases.[1] In an action by the United States and du Pont before a statutory[2] three-judge district court to enjoin collection of these taxes, *held,* injunction granted, one judge dissenting. The purchases by du Pont are exempt from state taxation because du Pont was acting as an agent of the federal government. *United States v. Livingston,* 179 F. Supp. 9 (E.D. S.C. 1959).

The power of the states to tax activities within their territory creates an inherent conflict between the interest of the federal government in protecting its activities from interference and the interest of the states in finding and maintaining sources of revenue. The doctrine of implied immunity of the federal government from state taxation was developed to resolve this conflict.[3] Although early applications of the doctrine also gave immunity to private persons and organizations performing services for the federal government,[4] the Supreme Court has in more recent decisions virtually eliminated this "derivative" immunity.[5] Underlying this change is an awareness of the vast increase in spending by the federal government, the new activities in which it is engaging, the decrease in the sources of revenue available to the states resulting from the application of the immunity doctrine, and the need of the states for greater revenue to perform their increasing governmental services. In its decisions the Court has relied on a test of "legal incidence": a tax imposed directly on the federal government or its agent is invalid; but if the effects are felt only indirectly, the tax is valid.[6] The Court has also implied that if the activity taxed is directly beneficial to the contractor, the tax is valid.[7] However, any benefit which du Pont might derive from the activity in the principal case would be only indirect and incidental. Many difficulties have arisen in the application of the legal incidence test to attempts to tax government contractors, and the Court has been forced to place much reliance on the terms of the contract

[1] S.C. CODE §65-1401 (1952) (sales tax); S.C. CODE §65-1421 (1952) (use tax).

[2] 28 U.S.C. §2281 (1958).

[3] The doctrine originated in McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

[4] *E.g.,* Panhandle Oil Co. v. Mississippi, 277 U.S. 218 (1928); Gillespie v. Oklahoma, 257 U.S. 501 (1922); Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842). Immunity was also applied reciprocally to exempt certain activities of the states from federal taxation. *E.g.,* Collector v. Day, 78 U.S. (11 Wall.) 113 (1870); Burnet v. Coronado Oil and Gas, 285 U.S. 393 (1932); Indian Motorcyle Co. v. United States, 283 U.S. 570 (1931). The derivative immunity doctrine was based on the theory that if the government's employees and contractors were forced to pay state taxes, the government would have to pay higher rates of compensation and thus would be subject to an economic burden.

[5] *E.g.,* Detroit v. Murray Corp., 355 U.S. 489 (1958); Alabama v. King and Boozer, 314 U.S. 1 (1941); Graves v. New York, 306 U.S. 466 (1939) (overruling Collector v. Day, *supra* note 4); Helvering v. Mountain Producer's Corp., 303 U.S. 376 (1938) (overruling Gillespie v. Oklahoma, *supra* note 4); James v. Dravo Contracting Co., 302 U.S. 134 (1937).

[6] *E.g.,* Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954); United States v. Allegheny County, 322 U.S. 174 (1944). See Van Brocklin v. Tennessee, 117 U.S. 151 (1886).

[7] See United States v. City of Detroit, 355 U.S. 466 (1958).

involved in each case. For example, in one case a state sales tax was held valid in its application to a cost-plus fixed fee contractor who purchased goods with his own funds and who took title to the goods himself, later conveying them to the government;[8] whereas, in another case a similar tax was held invalid because under the terms of the contract the government directly paid for the goods and title passed from the vendor to the government.[9] Since in the principal case the goods were purchased with money furnished by the government and title passed directly to it,[10] the tax was properly invalidated under the legal incidence test. Thus, this formal test enables the parties to a transaction to remove it from taxation by the inclusion of technical contractual provisions. Unfortunately, the test provides no room for a consideration of the need of the states for more revenue in the face of the rising costs of providing services and the increasing activities of the federal government. Also, this test fails to examine the basic issue involved — whether the particular tax is a sufficient interference with the performance of a federal function to require immunity.[11] Since the basic reason for the immunity doctrine is to protect the federal government against "interference" by the states,[12] and since a mere economic burden has been declared not to be an interference,[13] it would seem that the only tax which could interfere would be one which discriminates against the federal government.[14] Therefore, it would seem that a satisfactory resolution of the basic conflict requires a test which looks behind the formal incidence of the tax to the question whether there is an interference, in the sense of a discrimination, with the performance of a federal function.[15] This test would not necessarily mean the destruction of the immunity doctrine, for Congress has always had the undoubted right to grant an express immunity to any activity or function of the government.[16] Moreover, the determination to grant an immunity is a peculiarly proper one for the legislature, for

8 Alabama v. King and Boozer, *supra* note 5.

9 Kern-Limerick, Inc. v. Scurlock, *supra* note 6.

10 Principal case at 17.

11 Whether the tax is laid directly on the federal government has little relation to its effect on the performance of the federal function. For example, if the incidence of the tax in the principal case were on the vendor, rather than on the vendee, it would raise the price of the goods sold and thus have the same ultimate effect on the federal government, but the tax would be proper under the legal incidence test.

12 In McCulloch v. Maryland, *supra* note 3, the Court said, at 436: ". . . the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government."

13 *E.g.*, United States v. City of Detroit, 355 U.S. 466 (1958); Alabama v. King and Boozer, *supra* note 5; James v. Dravo Contracting Co., *supra* note 5.

14 This is the type of tax which was struck down in McCulloch v. Maryland, *supra* note 3. For a recent example, see Philips Chemical Co. v. Dumas Independent School District, 361 U.S. 376 (1960).

15 *Cf.* New York v. United States, 326 U.S. 572 (1946) (opinion of Mr. Justice Frankfurter).

16 *E.g.*, Carson v. Roane-Anderson, 342 U.S. 232 (1952); Bank of New York v. Supervisors, 74 U.S. (7 Wall.) 26 (1868). See also James v. Dravo Contracting Co., *supra* note 6.

it is only in Congress that an equitable balance between the conflicting interests of the federal government and the states can be determined. Congress is able to solve both facets of the problem by providing for immunity to whatever extent is necessary, and by providing for payments in lieu of taxes to reimburse states and municipalities for the additional services which they must perform for employees of federal projects within their territory.[17] Congress, or the federal agency involved, can also determine what added benefit is derived by the state by the presence of the federal project and adjust the payments in lieu of taxes accordingly.[18] In this manner the conflicting interests can be balanced and a decision reached which benefits each branch of the government without unduly harming the other.[19]

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[17] The present Atomic Energy Act provides for payments in lieu of taxation. 68 Stat. 952 (1954), 42 U.S.C. §2208 (1958). However, the payments are only in lieu of property taxes and are limited to that amount which would have been payable if the property were owned by a private person. If this provision were expanded to include a consideration of the sales and use taxes which would be payable, the difficulty exemplified in the principal case would be removed.

[18] Some of the other statutes which provide for payments in lieu of taxes are 54 Stat. 626 (1940), 16 U.S.C. §831*l* (1958) (Tennessee Valley Authority); 68 Stat. 95 (1954), 33 U.S.C. §986 (1958) (Saint Lawrence Seaway Development Corporation); 63 Stat. 428 (1949), as amended, 42 U.S.C. §1410(h) (1958) (Public Housing Administration). See also H. REP. No. 703, 83d Cong., 1st Sess. (1953).

[19] See U.S. COMMISSION ON INTERGOVERNMENTAL RELATIONS, A STUDY COMMITTEE REPORT ON PAYMENTS IN LIEU OF TAXES AND SHARED REVENUES (1955).