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B-159685 April 7, 1967

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The Honorable George H. Fallon, Chairman Committee on Public Works House of Representatives

Dear Mr. Chairman:

In the course of our work relating to Federal-aid highway programs, we learned that the State of Alabama Legislature has enacted a statute imposing a "privilege or license" tax of 1 percent on the gross receipts received by contractors from contracts entered into fro construction, reconstruction or building of any public highway, road, bridge, or street. Act No. 308, approved August 28, 1963, Title 51, Code of Alabama, section 596(1), 1965 Supp. Section 4, of the act provides, however, that the tax shall not apply to contracts with counties and incorporated cities or towns; it therefore appears that the tax is applicable only to contracts with the State itself. A copy of the full text of the act is enclosed.

Under the statute the proceeds of the tax are to be paid into the State Treasury to the credit of a pension's and security trust fund to be used for general welfare purposes. Since the State itself would bear the burden of the tax reflected in its highway construction contract prices, it is difficult to perceive any legitimate purpose in levying the tax in the first instance, the sole real effect of which, apart from the Federal-aid highway program, is to divert a portion of the State's funds appropriated for highways to other uses without actual production of revenue. To the extent that there is Federal participation in State highway contract costs, however, Alabama does not receive a benefit through payment by the Federal Government of a share of the tax burden reflected in contract prices.

There is little question, in our opinion, but that the Alabama tax would be construed as unconstitutionally discriminatory if the State sought to exact it against contractors dealing directly with the Federal Government while exempting those contractors dealing with local governmental subdivisions below the State level. See United States v. Clayton, 250 F. Supp. 827 (1965), and cases cited therein. The situation is somewhat different where, as under the Federal-aid highway program, the Federal Government is not being involuntarily taxed either directly or indirectly through contractors but, rather, is sharing on a more or less voluntary basis under congressional mandate in highway costs which include the burden of the tax. Nevertheless, because the tax appears to serve a meaningful purpose for the State only to the extent that State highway costs are reimbursed, and under the Federal-aid program such costs are reimbursed to a significant extent, it reasonably may be said that the tax is discriminatory in

its effect on Federal-aid highway funds.

We appreciate, of course, that taxes entering into the price structure of State highway costs are to be viewed as costs for Federal participation purposes. The Subcommittee on Roads of our Committee held hearings in May and June of 1963 on H.R. 5590, a bill would have prohibited the use of Federal-aid highway funds toward payment of taxes designed to provide revenues for State and local purposes. Apparently because of the complexity of distinguishing in some logical manner between taxes appropriate for payment and those to be excluded from payment, the bill was not enacted.

The considerations dealt with in the hearings on H.R. 5590 and the lack of legislation on the subject preclude this Office from concluding, as a matter of law, that any particular State or local tax is inappropriate for inclusion as part of highway construction cost. Yet it appears that the Alabama statute is unique in that its effect is to derive a share of Federal assistance greater than the real cost to the State would support. We can conceive of no other purpose for the tax other than to do just that. Further, it should be noted, if the tax is not questioned at 1 percent, there is no logical restraint, other than perhaps a sense of legislative conscience, against raising the levy to some higher percentage.

We bring the matter to your attention because of your Committee's past interest in the question of taxes included in the cost of Federal-aid highways and because the Alabama tax, while currently being included as a highway cost, nevertheless appears to transcend the various reasons reflected in the 1963 hearings for not legislating on the subject. We are also bringing the matter to the attention of the Chairman of the Senate Committee on Public Works. Since we have concluded that there is no basis for Office taking any action beyond disclosing the situation, we have not formally sought the views of the Federal highway officials or of the State of Alabama.

With respect to direct Federal contracts for highway construction in the State of Alabama, the amounts involved in recent years have been relatively small. It is our intention to discuss with Federal highway officials possible means for establishing a basis for Federal recovery of the amounts associated with the tax in question under future Federal contracts for highway construction in the State.

Sincerely yours,

(Signed) Elmer B. Staats Comptroller General of the United States