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B-160920, May 10, 1967

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TO THE SECRETARY OF THE AIR FORCE:

BY LETTER OF FEBRUARY 20, 1967, YOUR DEPUTY GENERAL COUNSEL ASKS ON BEHALF OF THE THREE MILITARY DEPARTMENTS WHETHER YOU MAY AUTHORIZE CONTRACTORS TO PAY REIMBURSABLE TENNESSEE SALES AND USE TAXES WHICH WERE RETAINED BY THE CONTRACTORS PURSUANT TO AN AGREEMENT WITH THE STATE PENDING THE OUTCOME OF A TEST CASE WHICH DETERMINED THE VALIDITY OF THE IMPOSITION OF THE TAX ON THE FEDERAL GOVERNMENT, DESPITE THE BARRING OF SAID TAXES, BY THE SIX-YEAR STATE STATUTE OF LIMITATIONS. THIS DISPUTE FOLLOWED THE PASSAGE OF THE TENNESSEE RETAILERS SALES TAX ACT, EFFECTIVE MAY 1, 1956 (TENN. CODE, SECTION 67-3004), IMPOSING A TAX AT THE SALES AND USE TAX RATE ON CONTRACTORS USING TANGIBLE PERSONAL PROPERTY IN THE PERFORMANCE OF THEIR CONTRACTS WITH OTHERS, IRRESPECTIVE OF THE OWNERSHIP OF THE PROPERTY AND THE THE PLACE WHERE THE PROPERTY WAS PURCHASED.

BECAUSE THE FEDERAL GOVERNMENT FELT THAT ITS CONTRACTORS WHO PURCHASED GOODS IN THE GOVERNMENT'S NAME AND WHO UTILIZED GOVERNMENT FACILITIES AS AGENTS OF THE GOVERNMENT WERE EXEMPT FROM SUCH STATE TAXATION, SUIT WAS BROUGHT WHICH EVENTUALLY CULMINATED IN UNITED STATES V BOYD 378 U.S. 39 (1964), HEREAFTER BOYD, A TEST OF THE VALIDITY OF THIS TAX. A COMPANION SUIT, UNITED STATES STEEL V BOYD, CHANCERY COURT AT NASHVILLE, TENNESSEE, NO. 80551, WAS BROUGHT TO TEST THE APPLICABILITY OF THE TAX IN THE CASE OF CONTRACTORS WHO WERE NOT ACTING AS AGENTS OF THE GOVERNMENT. HOWEVER, ACTION ON THIS LATTER CASE, BY MUTUAL AGREEMENT, WAS DEFERRED UNTIL THE CONCLUSION OF THE BOYD CASE.

THE FEDERAL GOVERNMENT, REPRESENTED BY THE ATOMIC ENERGY COMMISSION AT THAT TIME, AND THE STATE GOVERNMENT, REPRESENTED BY THE THEN DEPARTMENT OF FINANCE AND TAXATION, REACHED AN AGREEMENT CONCERNING THE PROCEDURES FOR HANDLING DISPUTED TENNESSEE SALES AND USE TAX CLAIMS DURING THE BOYD LITIGATION. UNDER THIS AGREEMENT, FOR SALES AND USE TAXES DUE ON OR AFTER MAY 1, 1955, THE CONTRACTORS FILED A MONTHLY TAX RETURN SHOWING THE TOTAL PROPERTY UTILIZED AND GOODS PROCURED FOR WHICH EXEMPTION WAS CLAIMED, BUT DID NOT REMIT THE TAX ITSELF PENDING THE OUTCOME OF THE SUIT. IN THE CASE OF GOODS PURCHASED FROM PRIVATE VENDORS CERTAIN FURTHER PROCEDURES INVOLVING RESALE CERTIFICATES AND PERIODIC CLAIMS FOR REFUNDS WERE REQUIRED, AND FOR UNLITIGATED TAXABLE EVENTS WHICH OCCURRED PRIOR TO MAY 1, 1955, IT WAS AGREED THAT:

"* * * IF REQUESTED, THE AGENCIES SHALL UNDERTAKE TO ARRANGE FOR SUCH WAIVERS OF THE APPLICABLE STATUTE OF LIMITATIONS AS MAY BE REQUIRED TO PRESERVE THE RIGHTS OF THE STATE TO ASSERT AND COLLECT TAXES IF IT IS SUCCESSFUL IN THE TEST LITIGATION; IN THE EVENT SUCH WAIVERS CANNOT BE OBTAINED, THE STATE MAY TAKE

SUCH STEPS OR ACTION, AS IT MAY DEEM NECESSARY OR APPROPRIATE IN THE CIRCUMSTANCES.'

ALTHOUGH NOT EXPRESSLY REQUIRED BY THIS AGREEMENT, FOR TAX CLAIMS ARISING AFTER MAY 1, 1955, THE TENNESSEE DEPARTMENT OF FINANCE SIMILARLY REQUESTED THE GREAT MAJORITY OF THE INDIVIDUAL CONTRACTORS TO EXECUTE WAIVERS OF THE STATUTE OF LIMITATIONS WHENEVER IT APPEARED A PAST TAX YEAR WOULD BE BARRED BEFORE THE CASES WERE DECIDED.

THE SUPREME COURT ULTIMATELY HELD THE TAX IN THE BOYD CASE WAS VALIDLY IMPOSED UPON THE CONTRACTORS, DESPITE ITS BEING PASSED ON TO THE FEDERAL GOVERNMENT, AND IN SO DOING DISPOSED OF THE ISSUES CONTROLLING THE UNITED STATES STEEL CASE. THE DEPARTMENT OF THE ARMY THEN, LATE IN 1964, ISSUED AN INSTRUCTION, ACQUIESCED IN BY THE STATE, OUTLINING PROCEDURES FOR THE CONTRACTORS' PAYMENT OF SALES AND USE TAXES REIMBURSABLE BY THE FEDERAL GOVERNMENT. AMONG OTHER THINGS, THIS INSTRUCTION PROVIDED:

"YOU ARE INSTRUCTED NOT TO PAY TAXES BARRED BY THE APPLICABLE STATUTE OF LIMITATIONS. IF A WAIVER OF THE STATUTE OF LIMITATIONS WAS GRANTED WITH THE GOVERNMENT'S WRITTEN AUTHORIZATION, AND IF SUCH WAIVER IS STILL CURRENT, YOU ARE AUTHORIZED TO EXTEND THE WAIVER UNTIL PAYMENT OF TAXES FOR THE PERIOD MAY 1, 1955 THROUGH NOVEMBER 30, 1964 IS MADE. IN ALL OTHER SITUATIONS THE APPROVAL OF THE CONTRACTING OFFICER MUST BE OBTAINED FOR GRANTING ANY WAIVER OR EXTENSIONS TO WAIVERS PERTAINING TO TAXES THAT ARE REIMBURSABLE BY THE GOVERNMENT.'

THE INSTRUCTION FURTHER PROVIDED THAT TAXES DUE FOR THE MONTH OF DECEMBER 1964, AND THEREAFTER, SHOULD BE PAID WHEN DUE.

IT NOW APPEARS FROM THE SEPTEMBER 19, 1965, LETTER FROM THE STATE DEPARTMENT OF REVENUE TO THE NAVY, THAT A SMALL NUMBER OF CONTRACTORS WHO WERE EXEMPTED FROM PAYING THEIR SALES AND USE TAXES WHEN DUE DURING THE BOYD LITIGATION, HAVE NOT WAIVED THE SIX-YEAR TENNESSEE STATUTE OF LIMITATIONS, TENN. CODE, SECTION 67-1323, WITH THE RESULT THAT SOMEWHAT MORE THAN $300,000.00 IN UNPAID TAXES ARE BARRED IF THE STATUTE APPLIES.

THE PARTIES, SINCE THE CONCLUSION OF THE BOYD CASE, WHICH SETTLED THE BASIC QUESTION OF APPLICABILITY OF THE TAX UPON GOVERNMENT CONTRACTORS, HAVE BEEN ATTEMPTING TO CONCLUDE THE UNITED STATES STEEL CASE WITH A CONSENT DECREE. THE GOVERNMENT PROPOSES TO INCLUDE IN THAT DECREE A GENERAL PROVISION APPLICABLE TO ALL CONTRACTORS OF THE MILITARY DEPARTMENT PERMITTING THEM TO SETTLE THEIR STATE TAX LIABILITIES FOR THE PERIOD MAY 1, 1955, THROUGH NOVEMBER 30, 1964, WITHOUT PAYMENT OF PENALTY OR INTEREST.

HOWEVER, THE STATE REFUSES TO CONSENT TO THIS CONDITION SO LONG AS THE GOVERNMENT MAINTAINS THAT THOSE CONTRACTORS WHO FAILED TO FURNISH WAIVERS OF THIS STATUTE OF LIMITATIONS FOR TAXABLE EVENTS AFTER MAY 1, 1955, NEED NOT PAY ANY BARRED TAXES.

THE MILITARY DEPARTMENTS' CONTENTIONS REST ON THE GROUNDS THAT THE STATE ACQUIESCED IN THE GOVERNMENT'S INSTRUCTION TO ITS CONTRACTORS EXPRESSLY PROHIBITING RECOVERY OF BARRED TAXES WITHOUT THE GOVERNMENT'S CONSENT, AND THAT THE INSTRUCTION DOES NOT CONTRADICT THE JULY 12, 1956, AGREEMENT BETWEEN ATOMIC ENERGY COMMISSION AND THE STATE BECAUSE THE AGREEMENT DOES NOT CONSTITUTE A GENERAL WAIVER OF THE STATUTE OF LIMITATIONS. THIS LATTER POINT DEPENDS UPON A PROVISION IN THE AGREEMENT STIPULATING THAT WAIVERS IN FAVOR OF THE STATE WERE

REQUIRED TO PRESERVE TAX CLAIMS ARISING PRIOR TO MAY 1, 1955, FOR:

"* * * WHILE THE AGREEMENT IS SILENT WITH RESPECT TO TAXES DUE ON OR AFTER MAY 1, 1955, IT IS NOT UNREASONABLE TO CONCLUDE THAT SPECIFIC WAIVER WOULD SIMILARLY BE REQUIRED FOR SUCH TAXES, AND, IN FACT THE STATE SECURED SUCH WAIVER IN MOST INSTANCES.'

THE STATE'S CONTENTIONS TO THE CONTRARY, AS SET OUT IN YOUR DEPARTMENT'S LETTER OF FEBRUARY 20, 1967, WERE:

"THE STATE CONTENDS THAT THE 1956 AGREEMENT * * * CONSTITUTED A GENERAL WAIVER BY THE GOVERNMENT OF THE STATUTE OF LIMITATIONS AND IN EFFECT TAKES THE POSITION THAT ITS PRACTICE OF SECURING WAIVERS FROM INDIVIDUAL CONTRACTORS SHOULD BE REGARDED AS A PROTECTIVE ACTION TAKEN IN AN ABUNDANCE OF CAUTION RATHER THAN AN INDICATION OF A REQUIREMENT THAT IT OBTAIN SUCH WAIVERS. ACCORDINGLY, THE STATE FEELS IT SHOULD NOT NOW BE FORECLOSED FROM COLLECTING SALES AND USE TAXES IN THOSE INSTANCES IN WHICH IT FAILED TO GET INDIVIDUAL WAIVERS OF THE STATUTE OF LIMITATIONS AND THE COLLECTION OF WHICH, ABSENT ANY WAIVER, WOULD BE BARRED . IN SUPPORT OF THIS POSITION IT MUST BE POINTED OUT THAT THE STATE: WAIVED ITS RIGHT TO IMMEDIATE COLLECTION OF THE SALES AND USE TAXES AS THEY BECAME DUE, A RIGHT ORDINARILY EXERCISED BY IT AS A MATTER OF COURSE; REFRAINED FROM ISSUING ESTIMATED TAX ASSESSMENTS, WHICH WOULD HAVE TOLLED THE STATUTE OF LIMITATIONS, TO CONTRACTORS WHO DID NOT PAY STATE TAXES ON A CURRENT BASIS (TENN. CODE, SEC. 67-3029); AND AGREED TO THE UNUSUAL PROCEDURE OF PERMITTING THE CONTRACTORS TO FILE TAX RETURNS ONLY, RATHER THAN REQUIRING SIMULTANEOUS PAYMENT OF THE DISPUTED TAX.'

THE RESOLUTION OF THE MATTER DEPENDS ON THE JULY 12, 1956, DOCUMENT OUTLINING PROCEDURES FOR HANDLING DISPUTED TAXES DURING THE PERIOD OF THE TEST LITIGATION, FOR ALTHOUGH THIS DOCUMENT IS NOT ENTITLED A CONTRACT AND IS UNSIGNED, IT IN FACT REPRESENTS THE CONTRACTUAL UNDERSTANDING OF THE FEDERAL GOVERNMENT AND THE STATE OF TENNESSEE WHICH UNDERLIES THEIR COURSE OF ACTION THROUGHOUT THE TIME IN QUESTION.

THE AEC LETTER OF JULY 12, 1956, FORWARDING COPIES OF THIS DOCUMENT TO THE STATE FOR ITS APPROVAL STATED THAT THE DOCUMENT CONTAINS PROCEDURES "* * * WHICH HAVE BEEN DEVELOPED WITH THE COOPERATION OF YOUR OFFICE," WHICH "* * * ADEQUATELY REPRESENT THE UNDERSTANDINGS WHICH WILL GOVERN THE HANDLING OF THE STATE'S CLAIMS," AND ALSO NOTED THE PROCEDURES HAD BEEN "* * * REVISED TO REFLECT AGREEMENTS REACHED DURING OUR CONFERENCE OF JULY 11 * * *.' WE MAY ASSUME THE STATE CONSENTED TO THIS CONTRACT IN WRITING, BUT IN ANY CASE THE PARTIES ACTED UNDER THE TERMS OF THE AGREEMENT FOR ALMOST TEN YEARS, SO THAT THEIR ACTIONS GIVE SUFFICIENT EVIDENCE OF AN INTENT TO TREAT THE DOCUMENT AS A BINDING CONTRACT.

WE MAY THEREFORE CONSIDER THIS OUTLINE OF PROCEDURES AS TANTAMOUNT TO A CONTRACT DEFINING THE RIGHTS AND DUTIES OF BOTH THE FEDERAL GOVERNMENT AND THE STATE OF TENNESSEE.

EXAMINATION OF THIS DOCUMENT SHOWS THAT, UNDER SECTION A, THE PARTIES AGREED TO A SET PROCEDURE FOR HANDLING SALES AND USE TAXES FOR THE PERIOD BEGINNING ON AND SUBSEQUENT TO MAY 1, 1955. UNDER THIS SECTION, THE STATE AGREED TO ACCEPT TIMELY FILED TAX FORMS WITHOUT REMITTANCE OF/THE SUM DUE PENDING THE OUTCOME OF THE SUIT, AND UNDER A 2-D THE PARTIES AGREED "THE DEPARTMENT WILL HOLD SUCH CLAIMS IN ABEYANCE AND WILL NOT ACT THEREON PENDING A FINAL DETERMINATION OF THE

OBLIGATION FOR OR EXEMPTION FROM PAYMENT OF SALES AND USE TAXES BY THE CONTRACTOR CONCERNED.' SECTION A-6 THEN PROVIDES:

"6--- WHEN ACKNOWLEDGED BY THE AGENCY CONCERNED THAT A PARTICULAR CONTRACTOR IS LIABLE FOR ALL OR PART OF THE TAX FOR WHICH AN EXEMPTION IS CLAIMED BASED UPON THE OUTCOME OF SUCH TEST LITIGATION, THE AGENCY SHALL AUTHORIZE AND DIRECT ITS CONTRACTOR TO PAY THE FULL AMOUNT OF THE TAX DUE. * * *.'

BOTH YOUR LETTER OF FEBRUARY 20, 1967, WHICH SAYS THE BOYD DECISION WAS DISPOSITIVE OF THE ISSUES IN THE CASE AT HAND, AND THE PROPOSED DECREE FOR THE UNITED STATES STEEL CASE ADMIT THAT, AS A RESULT OF THE TEST LITIGATION THIS TAX MAY PROPERLY BE LEVIED UPON THE CONTRACTORS INVOLVED. THEREFORE, UNDER THE ABOVE-QUOTED PARAGRAPH, IT IS THE EXPRESSED INTENT OF THE PARTIES THAT THE ,AGENCY SHALL AUTHORIZE AND DIRECT ITS CONTRACTOR TO PAY THE FULL AMOUNT OF THE TAX DUE.' THE WORD "SHALL," WHEN USED WITHOUT RESTRICTION OR LIMITATION, WOULD APPEAR TO BE THE AGREEMENT OF THE GOVERNMENT TO AUTHORIZE PAYMENT IN THIS EVENT, REGARDLESS OF OTHER FACTORS NOT GOING TO THE MERITS, SUCH AS THE STATUTE OF LIMITATIONS.

WE ARE THEREFORE OF THE OPINION THAT THE FEDERAL GOVERNMENT'S UNEQUIVOCAL PROMISE TO AUTHORIZE PAYMENT OF THE TAX INCLUDED A GENERAL WAIVER OF THE GOVERNMENT'S RIGHTS UNDER THE TENNESSEE STATUTE OF LIMITATIONS FOR THOSE TAXABLE EVENTS OCCURRING AFTER MAY 1, 1955.

NOR DO WE BELIEVE THAT, BY THE INCLUSION OF ANOTHER PARAGRAPH PROVIDING FOR THE PRESERVATION OF THE STATE'S INTEREST THROUGH OBTAINING WAIVERS FOR THE EARLIER CASES, THE PARTIES INDICATED AN INTENT TO AFFECT THE FIRST SECTION OF THE AGREEMENT. PARAGRAPH C-2, BY ITS TERMS, IS LIMITED TO EARLIER TAXABLE EVENTS, FOR THE PARAGRAPH ITSELF TWICE STATES IT IS CONCERNED WITH THE PERIOD " PRIOR TO MAY 1, 1955.' FURTHERMORE, THIS PARAGRAPH IS A SUBPART OF SECTION C OF THE CONTRACT, WHICH ACCORDING TO ITS HEADING TREATS ONLY PROPERTY "FURNISHED OR PROCURED PRIOR TO MAY 1, 1955.' SINCE ANOTHER COMPLETE SECTION, SECTION A, DEALS IN DETAIL WITH THE PROCEDURES "FOR THE PERIOD BEGINNING ON AND SUBSEQUENT TO MAY 1, 1955," WE CANNOT AGREE THAT THE PROCEDURE FOR PROTECTING THE STATE'S INTEREST IN THE EARLIER TAXABLE EVENTS SET OUT IN C-2 WAS MEANT TO APPLY TO THE CONTRACT GENERALLY. RATHER, IT APPEARS THAT BY THE CONSTRUCTION, CONTINUITY, AND SENSE OF THE CONTRACT, SECTION CD2 REQUIRES WAIVERS FOR ONLY THOSE TAXABLE EVENTS WHICH TOOK PLACE BEFORE MAY 1, 1955.

MOST IMPORTANT, READING THE DOCUMENT AS A WHOLE, WE BELIEVE IT SHOWS AN INTENT OF THE PARTIES TO PRESERVE THE FAIR INTEREST OF BOTH PARTIES IN ALL OF THE DISPUTED CASES WITHOUT THE NECESSITY FOR CONTINUOUS, PROTRACTED AND DUPLICATIVE LEGAL MANEUVERINGS, WHILE THIS TEST CASE WAS DECIDED ON ITS MERITS. FOR AN EXAMPLE OF THIS OVERRIDING INTENT TO HAVE THE ULTIMATE LIABILITY FOR THE TAX DEPEND SOLELY ON THE OUTCOME OF THE BASIC ISSUES DECIDED BY THE TEST LITIGATION, SEE PARAGRAPH E-1 WHERE THE PARTIES AGREED THAT, DURING THE COURSE OF THE LITIGATION,"NEITHER SIDE SHALL ATTEMPT TO DELAY SUCH CASES, OR TO HAVE THE CASES DETERMINED ON TECHNICAL PROCEDURAL DEFECTS OR OMISSIONS.'

THIS DOCUMENT MUST BE READ IN LIGHT OF THIS SPIRIT OF FAIRLY DETERMINING THE ULTIMATE TAX LIABILITY ON THE BASIS OF THE UNDERLYING ISSUE OF THE VALIDITY OF THE TAX ITSELF, AS DETERMINED BY THE COURTS, RATHER THAN SEEKING SIDE ISSUES OR TECHNICALITIES WHICH, IF GIVEN RESTRICTIVE INTERPRETATIONS, MIGHT RESULT IN SOME SMALL ADVANTAGE TO THE GOVERNMENT. IN SHORT, THE GOVERNMENT BOUND ITSELF TO AUTHORIZE PAYMENT OF THE DISPUTED TAXES IF THEY WERE FOUND TO BE VALID BY THE

COURTS, THE SUPREME COURT UPHELD THE VALIDITY OF THE IMPOSITION OF THESE TAXES, AND SO THE GOVERNMENT MUST NOW AUTHORIZE PAYMENT IN ACCORDANCE WITH ITS PROMISE.

ACCORDINGLY, IT IS THE OPINION OF THIS OFFICE THAT THE MILITARY DEPARTMENTS SHOULD AUTHORIZE THEIR CONTRACTORS TO PAY THE BACK TAXES WHICH HAVE BEEN THE SUBJECT OF THE PROCEDURES SET OUT IN SECTION A OF THE AGREEMENT OF JULY 12, 1956, REGARDLESS OF BOTH THE TENNESSEE STATUTE OF LIMITATIONS AND THE 1964 INSTRUCTION TO GOVERNMENT CONTRACTORS.