Vanderbilt Law Review

Volume 10
Issue 5 *Issue 5 - A Symposium on Law and Christianity*

Article 24

8-1957

State and Local Taxation – 1957 Tennessee Survey

Paul J. Hartman

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vlr

Part of the Taxation-State and Local Commons

Recommended Citation
Paul J. Hartman, State and Local Taxation -- 1957 Tennessee Survey, 10 *Vanderbilt Law Review* 1209 (1957)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol10/iss5/24

This Essay is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Law Review by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.

STATE AND LOCAL TAXATION—1957 TENNESSEE SURVEY

PAUL J. HARTMAN*

Governmental Immunity—Application to Taxpayer Who is Performing a Governmental Function.

Another chapter was written in the Tennessee saga of governmental immunity and local taxation by the Tennessee Supreme Court in *Roane-Anderson Co. v. Evans.*[1] That case involved Tennessee taxes levied on the exercise by a taxpayer of certain privileges. These privilege taxes were measured by the gross income which the taxpayer received as a result of its activities pursuant to a contract it had with the federal government in connection with atomic bomb production at Oak Ridge, Tennessee.

Under that contract taxpayer operated government owned cars and busses in transporting employees on the atomic bomb project at Oak Ridge, and it also supplied water and distributed electric current through government owned systems in the atomic bomb production area. Taxpayer operated a number of busses and cars "on the Area" and "off the Area" for the benefit of numerous employees at Oak Ridge, many of whom lived inside the Area and some outside the Area. All the vehicles involved in the transportation activities were the property of the federal government. Also, taxpayer had full control of a system of water works by which water was supplied to all the various consumers connected with the Oak Ridge project. Most, if not all, of these consumers paid for this service to taxpayer. The water works system also was owned by the federal government. Taxpayer also was in authority on the use and distribution of electric current throughout the Oak Ridge area. Fees for this service were paid to taxpayer, but the property was wholly Government owned.

For rendering its services, taxpayer was paid under a cost-plus-fixed-fee contract with the federal government. This fixed fee, over and above all costs, was $25,000.00 monthly.

Tennessee statutes impose taxes on various privileges, and measure the amount of the tax by the gross receipts received by taxpayer. These statutes are broad enough to cover the activities of taxpayer in the case at bar, but taxpayer resisted the tax on the ground of implied federal government immunity. In taxpayer's suit to recover the questioned tax paid under protest, it was claimed that taxpayer was acting as the agent of the federal government in performing the activities from which taxpayer derived all of the taxed income. In resisting taxpayer's claim, the taxing authority denied that taxpayer was en-

* Professor of Law, Vanderbilt University; member, Tennessee Bar.

1. 292 S.W. 398 (Tenn. 1956).

titled to assert the immunity of the federal government, taking the position that taxpayer was an independent contractor and liable for the tax.

The chancellor held that taxpayer was not an agent of the Federal Government but was acting as an independent contractor, exercising the privileges made the subject of the tax, and that the taxes paid under protest were legally exacted.

On appeal to the Supreme Court of Tennessee, the chancellor was reversed by a three to two vote of the Court and taxpayer was permitted to recover the taxes in question. Two petitions to rehear were filed, but the court stuck by its guns by a three to two vote. The tax was struck down as violative of the governmental immunity doctrine.

In its original opinion, the majority of the court seemed to strike down the tax on the ground that the taxed "revenue derived from the right to occupy and use Government property is as much Government owned as the property itself."[2] Then the majority concluded that "If this is true, it is clearly not subject to the tax sought to be exacted in this present litigation." In denying the petition to rehear, the majority wrote another opinion. This time they seem to find the tax violative of the governmental immunity doctrine because taxpayer "was exercising a privilege on behalf of the Federal Government."[3]

Also, throughout a good bit of the majority opinion runs the theme that the taxpayer was not conducting a "private business for profit," although taxpayer received a monthly fee of $25,000, over and above all cost, for supervising and directing the operation of government property.

A little later, the various reasons and facets of the majority opinion will be examined in some detail.

In a trenchant dissenting opinion, two members of the Tennessee Supreme Court took the position that the questioned tax was not levied upon any property belonging to the federal government, but to the contrary the property involved (the gross receipts) was used only as a measure in fixing the amount of the privilege tax levies against this taxed contractor. The dissenting opinion effectively answers the argument that taxpayer was an agent of the federal government in performing these services, the payments for which were taxed. Taxpayer did its own financing. All revenues from taxpayer's operations, along with damage deposits by tenants occupying the residences which belonged to the Government, were collected, deposited and disbursed in the name of the taxpayer. These collections were used by taxpayer in aid of its financing of the project. The only obligation of the Government was to reimburse taxpayer in accordance with the contract

2. *Id.* at 404.
3. *Id.* at 409.

provisions and to pay the fixed monthly fee of $25,000 over and above all costs incurred by taxpayer.

Taxpayer could not bind the Government to third persons and third persons could not look to the Government for payment.

Taxpayer apparently had a full rein in running these operations. It was employed by the Government to do the job because taxpayer alone allegedly had the "know how" necessary to accomplish the governmental objectives.

Hence, the dissenting justices were of the opinion that taxpayer was an independent contractor, and not an agent of the federal government. They felt that since the incidence of the tax was on the cost-plus-fixed-fee contractor, and only incidentally increased the cost of the project to the Government, this does not serve as *any* basis for immunity of the contractor from payment of the tax.

Presently, we will consider the question whether it makes any difference whether taxpayer was an agent or independent contractor, insofar as governmental immunity is concerned.

Since the majority opinion repeatedly stressed, as one of its bases for granting immunity from the tax, that taxpayer was not engaged in any private business for profit, it might be well to examine that position. Thus, the court distinguished the validly imposed tax in *Buckstaff Bath House Co. v. McKinley*,[4] on the ground that there the taxpayer was conducting a private business for profit; whereas, concluded the court, that is not so in the case at hand. In the *Bath House* case, taxpayer had leased a government owned bath house and was operating it for profit.

It might not be amiss to suggest that the taxpayer, in the case at hand, was in the most preferred position for making profit, if that is the test of tax validity. Taxpayer was guaranteed a profit of $25,000 every month, or $300,000 each year, over and above all its costs, by virtue of operating under a cost-plus lucrative fee contract.

Another ground put forth by the majority opinion to sustain its position granting tax immunity was that the tax was levied on government property.

The writer is utterly unable to agree that the tax was imposed on government property. The Tennessee Supreme Court's own decision in *Esso Standard Oil Co. v. Evans*[5] rather effectively scotches that argument. There an attempt to lay an inspection fee on government owned gasoline was invalidated under the governmental immunities doctrine; *but* when taxpayer stored that same government owned gasoline in its *own* storage tanks, a Tennessee tax for the privilege of storing that gasoline was upheld even though the Government ulti-

4. 308 U.S. 358 (1939).
5. 194 Tenn. 377, 250 S.W.2d 569, *aff'd*, 345 U.S. 495 (1953).

mately had to pay the amount of the tax because it had agreed to assume liability for all state taxes. The incidence of the tax was held to be on Esso, not on the United States, even "though the business was entirely done with property of the United States."[6] The Esso tax was not a tax *on* government property but on Esso. Nor can the writer agree that the tax measured by taxpayer's gross receipts in the case at hand was on government property. The taxed receipts wholly belonged to taxpayer, just as did the Esso receipts.

If this tax is to be nullified on the ground of implied governmental immunity, it is believed that a firmer ground for so doing is to say that taxpayer was engaged solely in carrying out a governmental function. The incidence of the tax, not its economic consequences, is now in vogue as a constitutional principle in determining whether a tax is forbidden under the doctrine of governmental immunity.[7] Hence, the tax in the case at bar had as its incidence privileges that were governmental functions. Under his approach, it really doesn't seem to make any difference whether taxpayer was an agent or an independent contractor insofar as governmental immunity is concerned.

It is felt that any further comment on the subject of governmental immunity as it relates to state and local taxes would be unwarranted at this time, in light of the fact that the *Vanderbilt Law Review* has recently treated this subject in an exhaustive manner.[8]

Privilege Taxes—Avoidance of Double Tax When Taxable Privilege Falls Under Two or More Items of Privilege Tax Statute—Taxation of Oil Depots and Service Stations.

Esso Standard Oil Co. v. Cobb,[9] called into question the application of another of Tennessee's privilege taxes. The final result of the case turned upon the interrelationship of three separate statutory provisions. Item 8(b) of the applicable taxing statute levies a tax on the privilege of selling at retail motor fuel, lubricants, etc.[10] Item 71(a) of the same statute levies a tax on the privilege of operating an oil depot.[11] The statute defines "oil depot" to mean a place where petroleum products or substitutes therefor, come to rest after movement in interstate commerce, or where such products are kept for sale after manufacture or processing in quantities greater than thirty-one gallons liquid measure. A third pertinent statutory provision provides

6. *Id.* at 388, 250 S.W.2d at 574.
7. Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954); Esso Standard Oil Co. v. Evans, 194 Tenn. 377, 250 S.W.2d 569, *aff'd*, 345 U.S. 495 (1953); Rice and Estes, *Sales and Use Taxes as Affected by Federal Governmental Immunity*, 9 VAND. L. REV. 204, 215-21 (1955).
8. Rice and Estes, *op. cit. supra* note 7; Sanders, *Constitutional Law—1953 Tennessee Survey*, 6 VAND. L. REV. 1159 (1953).
9. 301 S.W.2d 368 (Tenn. 1957).
10. TENN. CODE ANN. § 67-4203 (1956).
11. TENN. CODE ANN. § 67-4203 (1956).

that if a single business falls under two or more items of the relevant taxing statute, it shall pay only one tax, which shall be the highest.[12] This statutory section goes on to add, however, that the statute shall not be construed to permit any person to exercise two or more taxable privileges by the payment of only one tax.

In the case at hand, taxpayer (Esso Standard), which operated an oil depot, paid a tax for the privilege under item 71 of the statute. The question in the case was whether taxpayer must also pay a retail service station privilege tax under item 8(b). Taxpayer made sales of motor fuel and lubricants to farmers, contractors and truckers. The tax for operating an oil depot is higher than the service station tax.

In reversing the lower court, the Supreme Court of Tennessee agreed with the taxpayer's contention and held that taxpayer had been improperly held liable for the privilege tax levied on retail service stations under item 8(b). The Supreme Court had a double-barrelled rationale for its decision. First, the court concluded that, under the statutory definition, retail sales or distribution constitute an integral part of the business of maintaining an oil depot, for which taxpayer had paid the privilege tax. Second, the maintenance or operation of an oil depot is not, thought the Court, within the purview of item 8(b) relating to what are commonly known as service stations and repair shops. In short, it seems that selling oil is a common ingredient in both the oil depot privilege and the service station privilege. Thus, taxpayer was thought not to be exercising two taxable privileges within the purview of the relevant statutory section which provides that no person should be permitted to exercise two or more taxable privileges by the payment of only one tax.

Of course, where two or more taxable privileges are engaged in by a single business, then more than one tax can properly be levied.[13]

Taxability of Services in the Manufacture or Production of New Articles and the Incorporation of Such Articles in a Building.

The purview of the ordinary sales tax is generally limited to transfers of personal property for purposes other than resale by the purchaser.[14] Unless expressly made so by statute, the rendition of services ordinarily do not come within the scope of the sales tax.[15] But where

12. TENN. CODE ANN. § 67-4004 (1956).

13. Sims v. Carter, 173 Tenn. 263, 116 S.W.2d 1031 (1938). There Tennessee had a tax on the privilege of being a wholesale butcher, and another tax on the privilege of being a produce dealer. "Produce dealer" was defined as a person who buys produce such as vegetables, eggs, poultry and other farm products for resale or shipment. "Wholesale butcher" was defined as a person engaged in the business of being a wholesale dealer in fresh meats and poultry. Taxpayer slaughtered poultry and sold it. He was liable for two taxes, one for the privilege of being a wholesale butcher and one for the privilege of being a produce dealer.

14. *E.g.*, TENN. CODE ANN. §§ 67-3002 to -3004 (Supp. 1957). See Ball, *What Is a Sale for Sales Tax Purposes*, 9 VAND. L. REV. 227, 228 (1956).

15. See Ball, *What Is a Sale for Sales Tax Purposes*, 9 VAND. L. REV. 227, 228-

the rendition of services is coupled with a transfer of property, then troublesome problems arise. Where the personal property is transferred along with the performance of services, neither the services nor the property will be required to bear the tax, under the ordinary sales tax statute, in the absence of a statutory provision so taxing, if the transfer of the property is regarded by the court as a mere incident to the services.[16] While this rule finds application in the field of professional services also,[17] nevertheless there may come a point where certain activities of the professional man may fall within the compass of a "sale" for tax purposes. Thus, a pharmacist is regarded as rendering a non-taxable professional service when he fills a prescription, but when he dispenses patent medicine to a customer he is treated as making a taxable sale.[18]

But suppose the customer acquires an article that is not considered incidental to a service and the article admittedly is taxable, but certain separate services are performed on the article to make it suitable for the purpose for which it is intended to put the article? For example, a customer goes to a tailor shop, selects cloth from the shelf, and has a suit made to his order. There the tailor provides the customer with the cloth, buttons, lining, thread and other materials, plus the tailor's services in fashioning the materials into a finished suit. Must the customer pay a sales tax on the materials only, or will the subject of the tax include not only the goods that went into the fashioning of the suit, but also the cost of the tailor's services that went into the fashioning of the suit? Or, indeed, will there be a taxable transaction at all? It seems clear that if the customer had bought the materials for his suit and had taken them to the tailor, the purchase

---

35 (1956); Hellerstein, *The Scope of the Taxable Sale Under Sales and Use Tax Acts: Sales as Distinguished from Services*, 11 TAX L. REV. 261 (1956). In several states many types of services are made taxable by the statute. *E.g.*, LA. REV. STAT. § 47:301 (1950); MISS. CODE ANN. § 10104; TENN. CODE ANN. §§67-3002 to -3004 (Supp. 1957); W. VA. CODE ANN. § 999 (1955).

16. A well-known case on this point is Dun & Bradstreet, Inc. v. City of New York, 276 N.Y. 198, 11 N.E.2d 728 (1937). There the court held that the financial information service rendered by Dun & Bradstreet to their subscribers was a non-taxable service, although certain volumes containing financial information were delivered to the subscribers. These volumes could not be obtained without subscribing to the Dun & Bradstreet service, and no additional charge was made for the volume. This case, along with others of a similar texture, is considered in some detail in Ball, *What is a Sale for Sales Tax Purposes*, 9 VAND. L. REV. 227, 229-30 (1956); Glauberman, *The New York City Retail Sales Tax: What Constitutes a Sale of Tangible Personal Property?* 7 TAX L. REV. 94 (1951); Hellerstein, *The Scope of the Taxable Sale Under Sales and Use Tax Acts: Sales as Distinguished from Services*, 11 TAX L. REV. 261, 281-86 (1956).

17. Axelrod-Beacon Dental Laboratory, Inc. v. Philadelphia, 34 Pa. D.&C. 190 (C.P. 1938) (dental laboratory making dentures could not escape sales tax on ground that dentist purchased item for resale to patients; dentist held to be performing a service). For an annotation dealing with the furnishing of glasses or other optical accessories as a sale, see Annot., 157 A.L.R. 578 (1945).

18. Wray's Pharmacy, Inc. v. Lee, 145 Fla. 435, 199 So. 767 (1941).

of the materials would have been a taxable transaction.

Subject to a very limited number of exceptions the states have managed to reach, for sales tax purposes, such manufacturing, fabrication or processing services performed on goods.[19]

A problem in this general area, coupled with the additional problem of the incorporation of the finished article in a building, was presented in the recent Tennessee Supreme Court case of *John W. McDougall Co. v. Atkins*.[20] There the taxed contractor made air ducts which he installed in buildings. Without protest, he paid the sales tax on all the sheet metal used, but resisted the tax in so far as it would cover the cost of the labor used in fashioning this sheet metal into ducts.

Like those of many other states, the Tennessee sales tax is cast in terms of an exaction for the privilege of engaging in selling tangible property at retail or consuming tangible personal property.[21] A pertinent provision of the Tennessee statute expressly imposes the sales tax on certain specific uses of property. Although the statute has subsequently been amended, at the time of the case at hand, it provided:

> Where a manufacturer, producer, compounder or contractor erects or applies tangible personal property, which he has manufactured, produced, compounded or severed from the earth, for the account of or under contract with the owner of realty or other property, such person so using the tangible personal property shall pay the tax herein levied on the fair market value of such tangible personal property when used, without any deductions whatsoever.[22]

Under this statute, the court held that the taxpayer must pay a sales tax on the price of the sheet metal, plus the labor expense incurred by him in making the metal into a duct. That, of course, as the court pointed out, would be no more than if the taxpayer had paid for a completed duct, the price of which includes the labor in fashioning the sheet metal.

The taxpayer also objected to the tax on the ground that he was not a "manufacturer" within the purview of the taxing statute. In

19. See Hellerstein, *The Scope of the Taxable Sale Under Sales and Use Tax Acts: Sales as Distinguished from Services*, 11 TAX L. REV. 261, 286-88 (1956). Tennessee also makes manufacturing, processing and fabrication of various items of tangible personal property a taxable event under her sales tax statute. TENN. CODE ANN. §§ 67-3002 to -3004 (Supp. 1957).

20. 301 S.W.2d 335 (Tenn. 1957).

21. TENN. CODE ANN. §§ 67-3002 to -3004 (Supp. 1957). See Rose, *The Tennessee Retailers' Sales Tax* Act, 1 VAND. L. REV. 433 (1948).

22. TENN. CODE ANN. § 67-3004 (1956). Recently the statute has been amended by lengthy additions to it. One relevant part of the amendment was an addition to the quoted sentence, which reads: "provided, however, the foregoing shall not be construed to apply to contractors or subcontractors who fabricate, erect or apply tangible personal property which becomes a component part of a building, and which is not sold by them as a manufactured item." TENN. CODE ANN. § 67-3004 (Supp. 1957).

rejecting this contention, the court adopted as its definition of "manufacturer" the view that "one who gives new shapes, new qualities, new combinations to matter which has already gone through some artificial process" is a manufacturer.[23]

There are some additional facets to a case of this sort, some of which the court took cognizance. As we pointed out earlier, Tennessee, like most other states, taxes only retail sales which means sales for purposes other than resale. At first observation, it might appear that the owner who had the house built would be the actual consumer of the articles and that the taxed contractor only bought the ducts for purposes of resale to the owner. While there is a split of authority on this point, the contractor is regarded in many states as the consumer of building materials and supplies.[24] As the Tennessee statute shows, Tennessee was committed to that view when the case at hand was decided. Tennessee has now departed, in part, from that view. The Tennessee statute has been amended lately and it now provides that the tax need not be paid by contractors or subcontractors who fabricate, erect or apply tangible personal property which becomes a component part of a building, and which is not sold by them as a manufactured item.[25]

In resisting a sales tax, building contractors also have taken the position at times that the act of attaching the personal property to real estate deprives the personalty of its character as such so as to deprive the transaction of the character of a sale of personal property, because the title passes by accession. This argument has met with

23. 55 C.J.S., *Manufacturers* § 1 (1948).

24. *E.g.*, in State v. Christhilf, 170 Md. 586, 185 Atl. 456 (1936), the builder escaped a tax imposed for the privilege of selling at retail on the ground that the builder consumed the building materials in building a highway and a building for the University of Maryland. Consequently, he did not sell the property. ". . . We cannot agree with the view that there is a transfer of title to so many feet of lumber, kegs of nails, thousands of brick, perches of stone, cubic yards of concrete, or other items of materials entering into a lump sum contract, for a complete job or structure, which, when erected on the customer's land, is as much real property as the land itself and is by no sort of definition or reasoning 'tangible personal property.'" 185 Atl. at 458.

In R. S. Blome Co. v. Ames, 365 Ill. 456, 6 N.E.2d 841 (1937), the builder did not escape a tax levied on the business of selling tangible personal property for use of consumption and was subject to the retailers' occupation tax whether such transfer was by sale or by accession. The owners of the buildings were to be held the ultimate users or consumers contemplated by the sales tax statute. "Appellants (builders) transfer title to all materials which they furnish to the owners of the real estate. It makes no difference whether such transactions be by sale or accession. The transfer named in the act is, 'any transfer of title to tangible personal property.' Appellants at no time acquire or transfer title to any interest in real estate. The real estate at all times is the real estate of the owners with whom appellants contract. It makes no difference that the moment the title to the personal property leaves appellants and vests in such owners of real estate, by operation of law it becomes, eo instanti, real instead of personal property. The fact remains that all the title the appellants transfer, whether by sale or accession, is title to personal property." 6 N.E.2d at 842.

25. TENN. CODE ANN. § 67-3004 (Supp. 1957).

success in some states, but not in others.[26]

Building contractors also have argued that they do not come within the sales tax for the reason that they make no sales but render services, and the materials they furnish are only incidental to the service they render.[27] While the Tennessee statute involved in the case at hand expressly made such activity a taxable transaction, even in the absence of express statutory authority such argument by the building contractors generally has not met with success.[28]

26. See note 24 *supra,* for authorities illustrating, along with other points, these conflicting views.
27. *E.g.,* R. S. Blome Co. v. Ames, 365 Ill. 456, 6 N.E.2d 841 (1937).
28. *E.g.,* R. S. Blome Co., *supra* note 27.