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1983 JAN 17 PM 3 09
PROCEEDINGS BEFORE

SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 81-969
TITLE WASHINGTON, ET AL., Appellants
v. UNITED STATES
PLACE WASHINGTON, D. C.
DATE January 10, 1983
PAGES 1 - 44



ALDERSON REPORTING

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C O N T E N T S

ORAL ARGUMENT OF

PAGE

KENNETH O. EIKENBERRY, ESQ.,
on behalf of the Appellants.

3

STUART A. SMITH, ESQ.,
on behalf of the United States.

24

KENNETH O. EIKENBERRY, ESQ.,
on behalf of the Appellants - rebuttal

43

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P R O C E E D I N G S

CHIEF JUSTICE BURGER: We'll hear arguments first this morning in Washington against the United States. Mr. Attorney General, you may proceed whenever you're ready.

ORAL ARGUMENT OF KENNETH O. EIKENBERRY, ESQ.
ON BEHALF OF APPELLANTS, WASHINGTON, ET AL.

MR. EIKENBERRY: Mr. Chief Justice and may it please the Court:

This case involves the effort of the United States, successful so far, to prevent the State of Washington from deriving any sales tax or use tax from the significant federal construction that's going on in our state. I'd like first to explain what the controversy is about as a practical matter and then proceed on to the decisions of this Court and how we believe they do allow the application of this sales and use tax.

Washington imposes a general retail sales tax on the sales of tangible personal property and other services in the State of Washington. We do have the usual complementary use tax on the other side of it. There is a single rate of 5.4 percent embodied in a single statute applicable to all of these sales occurring in the State, and this by far is our single

1 largest source of general revenue in the State of
2 Washington. We do not have, as is common, an income
3 tax, because that is prohibited by our Constitution.

4 Under our system federal contractors are
5 treated the same way as most other buyers of tangible
6 personal property. When they buy bricks or nails or
7 cement for incorporation into a construction project,
8 they're treated the same way that you or I would be
9 treated if we were buying the same things to improve our
10 homes. 5.4 percent would be added on to the cost of
11 those materials and we would pay it to the seller. The
12 same is true if we bought an automobile or food or
13 cigarettes or whatever.

14 The legal problem arises because we treat
15 federal contractors differently from nonfederal
16 contractors in the construction projects. Ironically,
17 the Federal Government is challenging our system, which
18 gets more revenue out of nonfederal construction than it
19 does for federal construction, and this is true because
20 for nonfederal construction projects the 5.4 percent tax
21 is added to the entire price of a nonfederal job. That
22 is, not just for materials but also for labor and profit
23 and overhead. All of these go into the tax base.
24 Meanwhile.

25 QUESTION: I take it when you -- the

1 contractor adds that to his price to the owner, is that
2 it?

3 MR. EIKENBERRY: That is correct.

4 QUESTION: Well, but then he hasn't paid his
5 sales tax on his bricks, I take it; is that it?

6 MR. EIKENBERRY: If we're talking about a
7 nonfederal contractor, Your Honor, that sales tax is
8 added to the price that's finally presented.

9 QUESTION: But the contractor hasn't paid a
10 tax when he buys his bricks?

11 MR. EIKENBERRY: The private contractor does
12 not buy -- does not pay the materials sales tax when he
13 buys his bricks.

14 QUESTION: Exactly. Well, a while ago you
15 said that when a contractor buys bricks or his materials
16 he pays a tax. Well, he doesn't.

17 MR. EIKENBERRY: The federal contractor does,
18 Your Honor.

19 QUESTION: I know, but the private contractor
20 does not.

21 MR. EIKENBERRY: All right. Then I didn't
22 present it clearly, because what I was attempting to do
23 in the original way I described the sales tax is to show
24 that across the board on the sale of retail items,
25 whether it be bricks or cars or cigarettes or whatever,

1 there is at that point --

2 QUESTION: But there isn't when they sell to a
3 private contractor.

4 MR. EIKENBERRY: That's correct, Your Honor,
5 absolutely.

6 QUESTION: He is not paying that tax.

7 QUESTION: General Eikenberry, if the State
8 itself or one of the political subdivisions of the State
9 is building a construction project, what is the tax in
10 that instance.

11 MR. EIKENBERRY: It is the same 5.4 percent at
12 the time --

13 QUESTION: On the entire construction cost?

14 MR. EIKENBERRY: Yes, Your Honor, that's
15 correct.

16 QUESTION: So if the State itself were
17 building it is treated like a private citizen would be --

18 MR. EIKENBERRY: That is true, Your Honor.

19 QUESTION: -- in a building project.

20 QUESTION: And with respect to private and
21 State contracts, the State taxes the contract price at
22 the time the contractor delivers possession to the
23 owner?

24 MR. EIKENBERRY: That's true, Your Honor,
25 including overhead, profit, materials, and everything

1 that went into it.

2 QUESTION: General, have you finished?

3 MR. EIKENBERRY: Yes, Your Honor.

4 QUESTION: I take it you concede that the '75
5 amendment was to catch federal construction?

6 MR. EIKENBERRY: There's no question but what
7 this statute was designed to apply the sales tax to
8 these transactions, which were significant in our State
9 and we believe deserve to help bear the brunt of cost of
10 services delivered by State government.

11 QUESTION: In a sense, the State of Washington
12 is a victim of its own legislative move back in 1941,
13 isn't it?

14 MR. EIKENBERRY: I would resist categorizing
15 it as a victim, Your Honor, because, like most states,
16 these taxing schemes evolve over a period of time and as
17 circumstances change and one type of activity increases
18 it becomes more apparent --

19 QUESTION: But you're a victim only in the
20 sense you have this litigation on your hands --

21 MR. EIKENBERRY: Well, yes.

22 QUESTION: -- only in the sense you have the
23 litigation on your hands.

24 QUESTION: Well, if you treated all
25 contractors like you treat Government contractors there

1 wouldn't be any problem, would there?

2 MR. EIKENBERRY: That's certainly true, Your
3 Honor.

4 QUESTION: Because the federal contractor
5 could pass it on to the Federal Government in terms of
6 his price.

7 MR. EIKENBERRY: That's absolutely true, Your
8 Honor. We would be back under the rules that were
9 applicable --

10 QUESTION: Yes, yes.

11 MR. EIKENBERRY: -- with the Dravo Contracting
12 case.

13 QUESTION: In '35, wasn't it?

14 MR. EIKENBERRY: Yes. 1937 I believe was the
15 time that the Court made that step and said that it was
16 entirely appropriate to apply such a tax.

17 If I may --

18 QUESTION: Go ahead. I'm sorry.

19 MR. EIKENBERRY: In fact, that's the position
20 being taken here by the Government, we believe, in
21 advancing these arguments, that is, that if the same
22 identical tax were applied then to contractors in the
23 private sector then there would be no argument.

24 On the contrary, we're saying that the fact
25 that everybody pays in our state a retail sales tax,

1 that the tax on the nonfederal construction, applied the
2 way it does, makes all the difference in the world
3 constitutionally speaking, and that the Government's
4 objections are formalistic and hypertechnical. We
5 believe the principles of federalism and the purpose of
6 the supremacy clause does not require this kind of
7 rigidity or inflexibility.

8 Further, we believe the objections of the
9 United States disregard the common sense that this Court
10 has embodied in prior decisions beginning with the case
11 of James against Dravo Contracting Company in 1937,
12 proceeding on up through the U.S. against Fresno County
13 case in 1977 and as recently as last year, the same
14 principles being articulated in U.S. against ^{New} Mexico.

15 I'd like to suggest a case that illustrates
16 the hypertechnical approach being relied on by the
17 Government. As long ago as 1939 in Southern Pacific
18 Railway against Gallagher in the State of California, a
19 taxpayer was arguing that application of the use tax to
20 property that they brought into the state from out of
21 state was unfair and discriminatory as far as the
22 interstate commerce clause was concerned because it did
23 not equate with a state retail sales tax, which of
24 course applied to vendors and vendees in that state.

25 One of the reasons for the complaint was the

1 theory that the retailer might be able to absorb part of
2 that tax, and this Court said no, that that was
3 hypertechnical, the difference in the legal incidence in
4 the way those taxes were applied made no constitutional
5 difference at all. And as the Court said, there is an
6 equal charge against what is used, whatever its source.
7 And this is the approach we're urging on the Court to
8 take today with regard to this hypertechnical, what we
9 believe formalistic complaint.

10 We're submitting the Court should construe the
11 supremacy clause so as to protect the Federal Government
12 against a state tax which places the Government at a
13 competitive disadvantage in obtaining resources
14 necessary to perform its functions, but at the same time
15 construing the supremacy clause so as to allow the state
16 the greatest flexibility to fashion a tax scheme that
17 will fit our particular circumstances.

18 We certainly acknowledge, just to lay the
19 groundwork, that the state may not lay the incidence of
20 a tax directly on the Federal Government. That is
21 McColluch against Maryland, starting 160 years ago. And
22 that is why the legal incidence of this tax was not
23 imposed on the Government here in the State of
24 Washington.

25 And of course, just to make the step, this

1 Court held that a state -- it diverted from that and
2 said that the state may impose a tax on people dealing
3 with the Federal Government in 1937 in the James against
4 Dravo case, and this Court held that that may occur even
5 though the cost of that tax is passed on to the Federal
6 Government, even though that becomes an expense of doing
7 that business.

8 So that brings us, I believe, to the test, the
9 question here before the Court today: What is the test
10 that should be applied to determine whether a tax with
11 those dealing with the Federal Government is
12 discriminatory under the supremacy clause? Now, the
13 Court, as I say, indicated it was all right for a state
14 to tax contractors dealing with the Federal Government
15 if the same tax is imposed on all other contractors, and
16 in so doing the Court implicitly accepted the principle
17 that economic forces will work the same in both the
18 federal and the nonfederal sectors.

19 And we suggest that we can go from that case
20 to say that they become economic burden partners in both
21 the federal and the nonfederal sectors. By economic
22 burden partners, we'd suggest that we have a case where
23 parties to a transaction which is subject to a tax,
24 where the legal incidence of the tax falls on one party
25 or the other and the economic burden of the tax will be

1 determined as part of the negotiations in response to
2 market forces which would apply to those kinds of
3 transactions at that time.

4 So of course the question is, does this
5 economic burden partner principle carry over to the case
6 we're presenting to the Court today, and we believe that
7 it does. The question is, does this principle apply
8 when the legal incidence of a tax is on a different
9 partner in the federal transaction than it does on the
10 partner in the nonfederal transaction.

11 QUESTION: In that sense the state tax is
12 discriminating against contractors with the Federal
13 Government, isn't it?

14 MR. EIKENBERRY: In that sense, Your Honor,
15 the incidence is on different partners in the
16 transaction, but I believe we can show that it is not a
17 discriminatory tax simply because that incidence is
18 placed on different partners to the transaction.

19 QUESTION: How do you distinguish the Moses
20 Lake Homes and Phillips Chemical Company cases that are
21 relied upon by the Solicitor General?

22 MR. EIKENBERRY: Each of those discrimination
23 cases, Your Honor, are a situation where the taxes were
24 different from the taxes being applied against other
25 people that might be in comparable transactions. In the

1 Moses Lake case, as you recall, we had a state sales tax
2 on leasehold interests of people renting federal
3 housing, and because of the way the tax was applied it
4 was simply higher than any other tax for similar
5 leaseholds.

6 In the case of Phillips, where we had a
7 manufacturing company leasing a property from the
8 Federal Government, producing ammonia, because of the
9 way the tax was applied again, it was simply higher than
10 it was to any other leasehold interest, and it states so
11 factually, we believe they're significantly different.
12 Here we have the same tax.

13 QUESTION: Wasn't the concern of the Court, at
14 least in Phillips and perhaps in Moses Lake too, that
15 the state treated contractors dealing with the state
16 more favorably than contractors dealing with the Federal
17 Government?

18 MR. EIKENBERRY: There was -- there was some
19 discussion about whether people in the same identical
20 situation as federal contractors were treated the same.
21 But I believe that the bulk of the concern of the
22 opinion was concerned with the fact that across the
23 board the tax was not the same.

24 QUESTION: Do you think that analyzing the
25 Washington -- the economic burdens of the Washington

1 transaction, it can be fairly said that Washington, that
2 the State of Washington treats those contracting with
3 the Federal Government less favorably than those
4 contracting with the State of Washington?

5 MR. EIKENBERRY: We say we do not treat them
6 less fairly, Your Honor, and --

7 QUESTION: Less favorably.

8 MR. EIKENBERRY: We say that they're being
9 treated equally in both the federal sector and the
10 nonfederal sector. And let me use the way this thing
11 developed in the Detroit case, U.S. versus City of
12 Detroit in 1958, where you had a situation of the tax
13 being imposed on the leasehold interest of the
14 Borg-Warner Corporation, doing private manufacturing,
15 and the Court upheld that tax because there was a
16 comparable tax on landowners who passed their cost on to
17 their tenants.

18 So there was incidence falling in different
19 places. It was on -- in the federal situation the tax
20 was on the tenant, and on the nonfederal situation the
21 tax was on the landlord. Nevertheless, the Court held
22 that there was an equalization process going on there,
23 that it was inevitable that these burdens would be
24 shared.

25 The Court did not use that expression, but it

1 was obvious that it was viewed as the burden of the tax
2 passing from the private landlord to his tenant and the
3 possessory interest tax passing from the Federal
4 Government's tenant to the Federal Government, and there
5 was an equalization of the tax that fell on the use of
6 property in that state, and therefore it was not
7 regarded as being discriminatory.

8 QUESTION: Well, Mr. Attorney General, the
9 federal contractor nevertheless has to put out the money
10 when he buys, five or six percent more when he buys his
11 materials. He's going to need more working capital in
12 that respect. As he goes along, he's going to perhaps
13 have progress payments. But beyond that, he won't be
14 treated the same economically unless he can get the
15 money from the Federal Government.

16 MR. EIKENBERRY: The economic forces of the
17 marketplace --

18 QUESTION: Right, he's going to have to pay it
19 and then he's going to risk whether or not he can -- how
20 much of it he can get from the Federal Government.

21 MR. EIKENBERRY: Your Honor is mentioning, of
22 course, the up-front money problem that we have
23 mentioned in our brief.

24 QUESTION: Yes.

25 MR. EIKENBERRY: And there is at least three

1 different aspects that need to be touched on in
2 responding to that.

3 First of all, the economic forces of the
4 marketplace are going to see to it that the parties in
5 negotiating the terms of their contract will balance
6 out, we believe, as between federal and nonfederal. In
7 other words, in the federal sector there are such things
8 as advance funding accounts that can be used and have
9 been used, that may completely eliminate that problem
10 for the private contractor, and over on the nonfederal
11 side there are comparable arrangements that can be
12 worked out.

13 In any event, it's significant, I think, to
14 point out that the Federal Government has not complained
15 of that as being a problem, nor is there evidence before
16 the Court or in the record on that matter.

17 If we can go ahead and, discussing this same
18 issue that's been raised here by the Court, compare what
19 occurred in the case of United States versus County of
20 Fresno, where we again had the legal incidence falling
21 on one partner in the federal transaction and a
22 different partner in the nonfederal transaction. There,
23 of course, under authority of state law a possessory --
24 a leasehold possessory interest tax was imposed against
25 tenants of the Federal Government. A comparable tax, a

1 property tax, was imposed by the state on landlords in
2 the private sector. And the Court in writing that
3 opinion presumed that the economic burden of that real
4 property tax on the landlord would be passed to the
5 tenant.

6 Now, of course the presumption then has to be
7 compared with the federal situation, and the Court said
8 nevertheless that the tax was reasonable, that it was
9 fair, that the same market forces applied to both
10 parties as they arrived at their pricing level, and that
11 the placement of the legal incidence in that case was
12 irrelevant.

13 Now, of course there is another matter that
14 comes out of that case that needs to be addressed, and
15 that was the matter, the reasons indicated by Justice
16 Stevens in his dissent that the tax did appear on its
17 face to be discriminatory because of the fact that the
18 Government initially, at least, in its pricing scheme
19 was collecting both the cost -- because they were basing
20 their prices on comparable market value or prices for
21 rental units, was including both the possessory interest
22 tax and the -- or rather, including the value of
23 property tax and then the tenant was having to pay the
24 possessory interest tax.

25 QUESTION: Refresh my recollection. Wasn't it

1 also true in that case that the possessory interest tax
2 was paid on state-owned property as well?

3 MR. EIKENBERRY: That is true, Your Honor.

4 QUESTION: Which is different from this case.

5 MR. EIKENBERRY: But nevertheless, the
6 principle is the same, because the only way to explain
7 the case and I believe the bottom line is that the tax
8 did not discriminate against the Government and thereby
9 breach the protective mantle of the supremacy clause in
10 that case, because the Government, even if it assumed
11 the burden of the tax by lowering its rents, would not
12 be placed at a competitive disadvantage vis a vis other
13 landlords who had to pay over a portion of their rent to
14 the state government.

15 QUESTION: Mr. Attorney General, if you're
16 right couldn't the State of Washington say with respect
17 to federal contractors, we're going to put a five
18 percent tax on you measured by the contract price to the
19 Government, and we're not putting the legal incidence on
20 the Government; you can do what you want to. You can
21 try to get the money back from the Government or not.
22 But anyway, you have a tax on you for the full amount of
23 the contract price, just like it's placed on private
24 contractors. The only thing there is that we make them
25 pass it on.

1 MR. EIKENBERRY: This would be an alternate
2 scheme that could be used, Your Honor, a gross receipts
3 tax of sorts applied to --

4 QUESTION: Applied solely to federal
5 contractors?

6 MR. EIKENBERRY: Well, I believe that we would
7 have to have a comparable tax on contractors --

8 QUESTION: Well, I just say -- your argument
9 is that really in effect, that your sales tax is a
10 comparable tax the way you now arrange it, namely five
11 percent added to the contract price that the owner must
12 pay.

13 MR. EIKENBERRY: Oh, yes. Let me agree with
14 the Court. Then the only distinction I was drawing is
15 that in our situation we have an identical tax, although
16 it's applied -- the incidence falls on a different party
17 in the nonfederal transaction.

18 QUESTION: Well, wouldn't you agree that if
19 your argument's right Washington could put whatever your
20 rate is, a five percent tax, on the contract price of
21 the Government contractor?

22 MR. EIKENBERRY: If I correctly understand
23 what's being posed here and the tax were identical in
24 its rate, yes, I believe we could, Your Honor.

25 QUESTION: As long as you didn't attempt to

1 put the legal incidence on the Government.

2 MR. EIKENBERRY: Absolutely. That would be
3 the final test, Your Honor.

4 QUESTION: General Eikenberry, what is
5 Washington law with respect to the obligation, duty of a
6 contractor with the state to pass along the sales tax?
7 Is that simply a question of the bargaining between the
8 parties?

9 MR. EIKENBERRY: It's bargaining between the
10 parties, Your Honor, and the forces that happen to be in
11 play in the marketplace at that time.

12 QUESTION: I thought you answered Justice
13 O'Connor a while ago that you -- that contractors
14 contracting with the state government are treated just
15 like private contractors.

16 MR. EIKENBERRY: Yes, I did. Did I
17 misunderstand?

18 QUESTION: No. I wanted to ask, if
19 contractors with the state government and private
20 contractors are treated alike, what is the law with
21 respect to the contractor's duty to pay and the
22 permissibility of his passing along the tax to the
23 ultimate owner, whether it's the state or a private
24 entity?

25 MR. EIKENBERRY: It's identical as between the

1 private and the state government being the customer,
2 Your Honor.

3 QUESTION: But aren't they required to pass it
4 on?

5 MR. EIKENBERRY: Yes, that's true, Your
6 Honor.

7 QUESTION: I think perhaps we haven't been as
8 explicit in our questions, or perhaps you haven't been
9 as explicit in your answers. If I'm a contractor in the
10 State of Washington and I contract with the Alpha Delta
11 Retirement Home to build a retirement home for them,
12 does Washington state law impair in any way the freedom
13 of bargaining between me as contractor and the Alpha
14 Delta Retirement Home as to who shall bear the incidence
15 of the tax?

16 MR. EIKENBERRY: Oh. No, you may not bargain
17 who bear the incidence of the tax. Legally it falls
18 definitely on the one party.

19 QUESTION: On which party?

20 MR. EIKENBERRY: It would fall on the private
21 party or the State. Nevertheless, the two parties to
22 that transaction may --

23 QUESTION: It falls on the owner.

24 MR. EIKENBERRY: The owner of the property for
25 whom the construction is being done. Nevertheless, the

1 two parties may recognize that the market forces in work
2 today say to me as a customer that I'm not willing to
3 accept the total price that results from what you said
4 the materials and your labor and your profit will be,
5 plus that tax. And therefore they can bargain and
6 arrive at a new price, so that the results will work out
7 the same.

8 QUESTION: But the legal incidence of the tax
9 is on the owner who is getting the building from the
10 contract.

11 MR. EIKENBERRY: Yes, sir.

12 If I may, I would save the remaining time for
13 rebuttal.

14 QUESTION: Let me ask you one more question.
15 How does the State -- it's not, then, a tax on doing
16 business, the way a sales tax is; it's a use tax on the
17 use of the property by the owner?

18 MR. EIKENBERRY: Yes. We have the comparable
19 use tax if sales tax has not been paid and things have
20 been brought in from out of state. So we have both the
21 sales tax on the retail sales and the use tax for --

22 QUESTION: How does the State collect that
23 from an owner?

24 QUESTION: The contractor is supposed to
25 collect it, isn't he?

1 MR. EIKENBERRY: Yes. Your Honors, if we're
2 dealing in a nonfederal situation the contractor
3 prepares a bill for his labor, materials costs, et
4 cetera, and then calculates a retail sales tax and
5 presents that, collects the money from the customer and
6 remits it to the State.

7 QUESTION: So that the contractor is actually
8 the entity through which the Tax Department of the State
9 of Washington collects the tax, even though you say the
10 legal incidence is on the owner.

11 MR. EIKENBERRY: That's true. And if I may
12 add one thing to that, Your Honor, there is an advantage
13 to the State in doing it that way because also we have
14 the legal ability if the tax is not collected to hold
15 the contractor seller liable, or we could go after the
16 --

17 QUESTION: How can you hold the contractor
18 liable if the incidence of the tax is on the owner?

19 MR. EIKENBERRY: Because we've said it's his
20 duty to collect it from the customer.

21 QUESTION: So as a practical matter, it's
22 really the contractor that pays.

23 MR. EIKENBERRY: I understand the point, Your
24 Honor. But legal incidence we believe is on the
25 customer.

1 QUESTION: General, is the contractor's profit
2 included in the base of the tax?

3 MR. EIKENBERRY: Is -- I'm sorry, I didn't
4 quite hear.

5 QUESTION: I understood that the tax when
6 you're dealing with parties other than the United States
7 Government is based on the cost of the project --

8 MR. EIKENBERRY: Yes, sir.

9 QUESTION: -- to the landowner.

10 MR. EIKENBERRY: Yes, sir.

11 QUESTION: Does that cost of the project
12 include the contractor's profit?

13 MR. EIKENBERRY: Absolutely, yes, sir.
14 Profit, services, labor, and the whole cost of the
15 project.

16 CHIEF JUSTICE BURGER: Mr. Smith.

17 ORAL ARGUMENT OF STUART A. SMITH, ESQ.,

18 ON BEHALF OF THE UNITED STATES

19 MR. SMITH: Mr. Chief Justice, may it please
20 the Court:

21 As the Court is well aware, there is a
22 fundamental tenet in our Constitution providing for the
23 immunity of the Federal Government absolutely from state
24 taxation. McCulloch established that federal tax
25 immunity, as Chief Justice Marshall said, is the

1 unaviodable consequence of that supremacy which the
2 Constitution has declared.

3 Now, we all agree that McCulloch established
4 that the states cannot lay a direct tax upon the United
5 States. But there is an important corollary to that
6 doctrine which is equally unquestioned. It is, as the
7 Court has said on numerous occasions, that a tax may be
8 invalid, even though it does not fall directly upon the
9 United States, if it operates so as to discriminate
10 against the Government or those with whom it deals. The
11 Court said that in the United States versus City of
12 Detroit and has reaffirmed that in Phillips Chemical
13 Company, Moses Lake Homes, and a whole host of
14 precedents.

15 This corollary is essential to the integrity
16 of the federal tax immunity principle, because otherwise
17 the very functioning of the Federal Government would be
18 impaired. For example, if a state attempted to tax the
19 income solely of federal employees, that tax would be
20 indisputably invalid. But an income tax laid upon all
21 residents of the state, which includes federal
22 employees, would be constitutional, as indeed this Court
23 held in Graves ex rel. versus O'Keefe.

24 So the rule that has emerged in more recent
25 terms from the decisions of this Court is that the

1 economic burden on a federal function of a state tax
2 imposed upon those who deal with the Federal Government
3 renders the tax invalid if it is not imposed equally on
4 the other similarly situated constituents of the state.
5 In our view, the Court of Appeals correctly identified
6 the Washington sales tax at issue here as a classic
7 example of discriminatory taxation.

8 All will agree, and the State indeed properly
9 concedes, that the Washington legislature engaged in a
10 purposeful attempt to circumvent the immunity of the
11 United States. The statutory history --

12 QUESTION: Well, you use the term "circumvent
13 the immunity of the United States," Mr. Smith. If the
14 Washington legislature looked around and said, look,
15 there are some people contracting with the Federal
16 Government who we think the decisional law will let us
17 tax, but our tax structure just isn't framed to get that
18 tax, so let's change it to tax what we can, would you
19 say that was a desire to circumvent the immunity of the
20 Federal Government?

21 MR. SMITH: It would be an attempt to do it,
22 but our view is that they haven't done it correctly here
23 under the precedents of the United States.

24 QUESTION: There are some ways they can
25 circumvent it and other ways --

1 MR. SMITH: Exactly.

2 QUESTION: The difference between tax evasion
3 and tax avoidance?

4 (Laughter.)

5 MR. SMITH: I think --

6 QUESTION: Mr. Smith, if the tax here, instead
7 of requiring the owner of the property to pay a tax
8 based on the full contract price, had a separate sales
9 tax, one on the owner for the labor involved and one on
10 the contractor for the cost of materials incorporated in
11 the project, and the tax on the federal contractors
12 remained the same as it is now, I assume you would say
13 that's constitutional. Is that right?

14 MR. SMITH: Well, the important thing, Justice
15 O'Connor, is that the federal contractors be treated the
16 same as all other contractors.

17 QUESTION: And under that assumption it would
18 be --

19 MR. SMITH: Under that assumption that would
20 be right.

21 QUESTION: -- and it would be fine.

22 MR. SMITH: In other words, so that the
23 Federal Government's immunity would prevent the state
24 from imposing a tax on the -- you know, on the
25 contractor's profit, you know, which would be the cost

1 borne by the Federal Government.

2 But the statutory history reveals that that
3 really, and the statute indicates, that that really
4 isn't what happened here, because in 1935 when this tax
5 was enacted the tax was on, the Washington sales tax,
6 was on sales to building contractors. That is, to use
7 the Attorney General's example, if a contractor
8 purchased a nail or some other component that went into
9 a house from a hardware company, that contractor would
10 have to pay the sales tax. All contractors would pay
11 that sales tax, whether -- no matter whom they dealt
12 with, the Federal Government, the state government, or a
13 private party. The tax was imposed on contractors.

14 In 1941 the State wanted to -- the State
15 changed the tax, and what it did was it changed the tax
16 to sales by contractors, so that the tax began to be
17 paid by consumers. Now, the State did this legitimately
18 in order to increase its tax base, in order to include
19 the contractor's profit in the tax base.

20 But because it did this and imposed the tax at
21 the customer level, of course, the Federal Government
22 was a customer; all those transactions became immune
23 under the absolute immunity of the Federal Government
24 that this Court has never questioned.

25 So now, for more than 30 years the State was

1 apparently content with this choice, that is, an
2 enhanced tax base in the private and state sphere,
3 gaining enhanced revenues from these sources at the
4 price of sacrificing -- and indeed, at the
5 constitutional price of sacrificing revenue from Federal
6 Government contractors.

7 And in 1975 it saw that, when federal
8 construction activity in the State of Washington became
9 greater and more intense, the State sought to include
10 somehow the Federal Government's contracting activity in
11 its tax base, while retaining the enhanced tax base on
12 private construction. The State did not want to give up
13 that aspect of its tax law.

14 So in 1975 the State amended its sales tax to
15 impose, as we have it now, a tax upon contractors for
16 the United States, but not upon other contractors. Now,
17 there's no doubt, indeed, that this -- these amendments
18 intended to circumvent the federal tax immunity. The
19 legislative history indicates that, the staff reports
20 indicate it, that there some question as to whether this
21 was discriminatory under the decisions of this Court,
22 and indeed the State so acknowledges that intent.

23 Now, in our view these 1975 amendments
24 effectively single out the Federal Government's
25 contractors for state taxation, and therefore runs afoul

1 of the discrimination corollary under the immunity --

2 QUESTION: Regardless of the economic effect?

3 MR. SMITH: Regardless of the economic
4 effect.

5 QUESTION: Even if it's perfectly clear that
6 the Federal Government contractor, the whole transaction
7 of contracting with the Federal Government, will suffer
8 a lesser economic burden than the state contractors?

9 MR. SMITH: Well, that's true, regardless of
10 that effect.

11 QUESTION: And that's your position? That's
12 your position?

13 MR. SMITH: That is our position, and we think
14 it's a position which is supported by the decisions of
15 this Court, because rather than engaging in -- the
16 supremacy clause, as this Court has interpreted it
17 countless times, presuppose -- indicates the Founding
18 Fathers' attempt to avoid this clash of sovereigns,
19 clash of sovereigns between the Federal Government and
20 the state government. And because of that, the
21 supremacy clause betrays this apt principle that the
22 Federal Government and those with whom it deals cannot
23 be singled out for discriminatory taxation.

24 Now, in our --

25 QUESTION: Why do you call it

1 discriminatory?

2 MR. SMITH: Well, it is --

3 QUESTION: It's just different.

4 MR. SMITH: It's different, but --

5 QUESTION: It's not discriminatory. It's
6 discriminatory against the state and private
7 contractors.

8 MR. SMITH: Indeed.

9 QUESTION: It puts a lesser burden on the
10 Federal Government than it does on the State.

11 MR. SMITH: Yes, but I think as the Court
12 indicated in County of Fresno in describing the
13 McCulloch rationale, the Court said if the state's power
14 to tax the bank were recognized in principle, the Court
15 doubted the ability of federal courts to review each
16 exercise of such power to determine whether the tax
17 would or would not destroy a federal function.

18 The important thing, as the Court of Appeals
19 recognized here, is that once you have -- once you have
20 a state legislature's identification of federal activity
21 for different tax treatment, that that indicates a
22 potential for abuse which triggers the application of
23 the immunity clause.

24 QUESTION: Whether discriminatory or not.

25 MR. SMITH: Whether discriminatory or not.

1 And in our view this fits in perfectly, fits in
2 appropriately, with the Court's -- with the entire
3 panoply of decisions which examine the state taxes in
4 terms of where the legal incidence is imposed.

5 QUESTION: Although if they treated all
6 contractors alike and just put a sales tax on the
7 purchases of a contractor from all of his suppliers and
8 left it up to the contractor to pass it on to his owner
9 if he could, the fact that the United States would end
10 up paying the tax would not invalidate it.

11 MR. SMITH: Indeed, that was the situation in
12 1935, and that really flows from the Court's statement
13 in King & Boozer.

14 QUESTION: Even though the -- even though now
15 the burden on the Federal Government, if you accept, if
16 you accepted the Washington tax, is no greater.

17 MR. SMITH: Indeed. But you know, that
18 argument --

19 QUESTION: It's just different.

20 MR. SMITH: It's just different. But that
21 argument is frighteningly reminiscent of what the State
22 of Maryland must have argued before the Court in
23 McCulloch versus Maryland. It said: Trust us; we're
24 not going to make this that onerous or difficult.

25 QUESTION: Well, but I think one might fairly

1 say your argument is reminiscent of a good deal of the
2 decisional law of this Court before James versus Dravo
3 and King & Boozer, where it was simply an exultation of
4 form over substance.

5 MR. SMITH: I don't think so, Mr. Justice
6 Rehnquist, and the reason I don't think so is that we
7 are examining here where the legal incidence of this tax
8 falls. It's a tax, it's a sales tax which is imposed
9 only on federal contractors. And we look around and say
10 to ourselves, if company A goes into the State of
11 Washington and it engages in a federal contract, it has
12 to pay this tax and it has to, as Justice White pointed
13 out, put up this money up front and whether it gets back
14 the money or not is really wholly problematic. And if
15 it does business with a private party it doesn't have to
16 pay the tax.

17 Now, that --

18 QUESTION: That's a burden -- that's an
19 economic burden argument you're making now.

20 MR. SMITH: No, it isn't. It is not an
21 economic burden argument. In our view it is an
22 examination of where the legal incidence of this tax
23 falls. I have no quarrel --

24 QUESTION: It's just a description of how
25 they're treated differently?

1 MR. SMITH: It's a description of how they're
2 treated differently. And indeed, as I think the Court
3 indicated in County of Fresno, once the principle is
4 breached this different treatment indicates that, you
5 know, the constitutional principle is also breached.
6 And in our view this --

7 QUESTION: Mr. Smith, in the County of Fresno
8 we have exactly the same situation we have here. The
9 tax was placed on renters who rented from the Federal
10 Government, and we got around that in County of Fresno
11 by making certain assumptions about who was going to
12 bear the economic burden.

13 Why can't we make the same assumptions here
14 and assume that, for instance, that the tax couldn't be
15 shifted from the federal contractor to the Federal
16 Government itself?

17 MR. SMITH: I think that kind of assumption --
18 well, first of all, let me answer that in two parts. I
19 think, to begin with, the assumption that the Court
20 engaged in in County of Fresno, equating the renters in
21 private property with the Forest Service rangers, was an
22 appropriate, an arguably appropriate analogy between two
23 parties who occupied similar positions in the economic
24 spectrum, that is, renters of property.

25 Here we have a situation where the State is

1 attempting to save its tax by pointing to the customers,
2 the private customers, and saying, we don't have to
3 worry about the fact that we're not taxing the private
4 contractors because we're taxing the private customers.
5 The private customers are not comparable to
6 contractors. They're really quite different.

7 And the point -- in response on another level,
8 Justice O'Connor, let me simply say that that argument,
9 the point is that somehow it's all going to work out
10 because the customers are bearing the tax, I think
11 places unnecessary or improper emphasis on the fact that
12 these taxpayers here are projects, they are construction
13 projects.

14 The taxpayers in this case, in these cases,
15 are not projects; they are parties. And in this
16 particular instance we have a situation where the
17 contractor who deals with the Federal Government is
18 subject to tax and the contractor who deals with a
19 private party and the State is not subject to tax.

20 In fact, the State responds by saying, as
21 you've suggested, that the discriminatory treatment
22 could be cured simply if the United States would
23 reimburse its contractors. But really, that turns the
24 immunity principle on its head. It identifies the
25 federal tax immunity, the absolute immunity that this

1 Court has repeatedly indicated it has never questioned,
2 as the cause of the discriminatory treatment here.

3 The immunity is not the problem, we submit.
4 It is the first principle that's to be considered, the
5 unavoidable consequence of that supremacy that the
6 Constitution has declared.

7 We think that the State cannot seek to
8 identify the Federal Government's either refusal or
9 disinclination to reimburse its contractors as an
10 affirmative justification for its invalid discriminatory
11 or indeed different treatment of federal contractors.
12 And --

13 QUESTION: Of course, the Government got into
14 this case only because it reimbursed and then sued for a
15 refund, didn't it?

16 MR. SMITH: I assume so, I assume so.

17 QUESTION: You assume?

18 MR. SMITH: I assume that the Government --
19 although I suppose that the Government -- the Government
20 is a party in this case. I'm not sure that the
21 Government has reimbursed it, but I assume that that's
22 probably right.

23 QUESTION: I thought you did reimburse them.

24 MR. SMITH: I think that's probably right.

25 But again --

1 QUESTION: But we're talking about a case
2 where the contractor suffered no economic burden
3 whatsoever.

4 MR. SMITH: But again, Justice White, I don't
5 think that we can -- I don't think that we can assume
6 that the Federal -- to assume that the Federal
7 Government will make that kind of reimbursement is in
8 effect to really, you know, make a farce of the Federal
9 Government's immunity. Because if you structure a
10 state's taxing statute on the assumption that the
11 Federal Government will make this contribution and
12 that's the way we're going to achieve equal treatment,
13 it seems to me that the immunity principle is seriously
14 threatened.

15 QUESTION: It sounds a lot like your brief in
16 Fresno.

17 MR. SMITH: No, I don't think it sounds like
18 my brief in Fresno, for one simple reason. I think that
19 the Court will recall Fresno, in Fresno the principal
20 argument we made was that the tax on the Forest Ranger's
21 possessory interest endangered and impaired the ability
22 of him to discharge his duties. And the Court indicated
23 that there could be a segregation, a separation of his
24 private residential aspect, of his house, with the
25 Court's -- you know, with the taxation of his axe, et

1 cetera, et cetera.

2 So I think the cases are really quite
3 different. But I think that the Fresno principle is
4 something that it seems to us that the Court of Appeals
5 correctly identified as the appropriate rule on which to
6 invalidate this tax. That is, that you can't treat
7 those who deal with the Federal Government differently
8 than those who deal with other parties, that that
9 difference in treatment triggers the kinds -- the clash
10 of sovereigns that the supremacy clause was designed to
11 prevent.

12 QUESTION: Mr. Smith, before you leave Fresno,
13 I should have reread the case before today, but is it
14 not true that in the California possessory interest tax,
15 not only did the tax apply to tenants of all publicly
16 owned property, but to any property the owner of which
17 was tax exempt, such as charities? Wasn't there a broad
18 class of properties?

19 MR. SMITH: I think that's right.

20 QUESTION: Doesn't that make it quite
21 different from this case?

22 MR. SMITH: I think it does.

23 QUESTION: But if you admit that, then what if
24 Washington were to amend its tax to take the approach it
25 now applies just to the Federal Government and create a

1 class of contracts including state agencies and the like
2 and treat them the way they now treat the Federal
3 Government? Would that save it?

4 MR. SMITH: Well, I'm not sure it would save
5 it, only because you then would have -- you then have to
6 examine whether it included a sufficient number of
7 similarly situated constituents within the tax to
8 protect the Federal Government. In fact, the dissenting
9 opinion -- the dissenting opinion in Montana versus
10 United States really sort of raises that problem,
11 although it was --

12 QUESTION: Well, yes, but --

13 MR. SMITH: -- talking about the merits, it
14 was talking about the merits of a case that the Court
15 never reached.

16 QUESTION: So did the dissenting opinion in
17 Fresno, but it wasn't very persuasive.

18 MR. SMITH: But let me simply say that I think
19 that when you're talking about who is a similarly
20 situated constituent you have to, I think, start from
21 the notion that the Federal Government is entitled to a
22 full measure of protection and the inclusion of all
23 similarly situated constituents. Because I don't -- I
24 think it would be -- I would counsel against the Court
25 engaging in a kind of quantification of how much is

1 enough.

2 It seems to us that the supremacy clause, if
3 it's going to have any meaning, has to protect the
4 Government by -- in other words, the notion should not
5 be that these people have sufficient political clout and
6 these -- and that will carry the day, because those
7 things are terribly ephemeral.

8 I think from a constitutional point of view
9 the Federal Government has to be protected by including
10 all similarly situated people within the tax, and that
11 in our view here means the contractors, and that, the
12 absence of the contractors here which deal with the
13 State and with private parties, is glaringly absent.

14 If the State wants to return to 1935, we don't
15 have any quarrel with that. If it wants to impose a tax
16 based on the gross receipts of all contractors, James
17 versus Dravo Contracting Company establishes the
18 validity of that kind of tax.

19 But here we have a situation where the State
20 really wants to have it both ways. It wants its
21 enhanced tax revenue from the enhanced base in the
22 private sphere, but it also wants to catch the federal
23 contracts. And in our view it can't do that in this
24 context.

25 And in that respect, I simply want to

1 identify, we talked at the beginning about purposeful
2 circumvention. There are -- there are precedents of
3 this Court that indicate that the identification by a
4 state of federal activity or tax-immune income for
5 taxation by circumvention is improper and imperils the
6 supremacy clause. And I would refer the Court to an
7 old, but in our view perfectly appropriate, decision,
8 Miller versus Milwaukee, which dealt with that sort of
9 thing; and Moses Lake Homes, which in fact -- Moses Lake
10 Homes --

11 QUESTION: Hasn't Miller versus Milwaukee been
12 rather substantially limited by comments in later
13 opinions?

14 MR. SMITH: I don't think it's been limited.
15 I think what the Court indicated was it still stands for
16 the important proposition that you can't discriminate
17 against the Federal Government and those with whom it
18 deals.

19 And in fact, Moses Lake Homes, it seems to us,
20 answers the very attempt of the state here to recast the
21 absolute immunity that the Court has never questioned in
22 terms of a no competitive disadvantage principle. If
23 the Court will recall in Moses Lake Homes, a case which
24 also came from the State of Washington, the State of
25 Washington imposed a higher tax on federal lessees than

1 state -- than private lessees. And the Court -- the
2 Ninth Circuit struck that tax down and remanded it to
3 the district court for recomputation to impose an
4 equivalent tax on the federal lessees. And when the
5 case came to this Court, this Court had no trouble
6 saying that a discriminatory tax like that was invalid.
7 Without further discussion, the whole tax was invalid.

8 So we're not really -- it seems to us it would
9 be wrong to demean the absolute immunity of the United
10 States from federal taxation and the anti-discrimination
11 principle which is part and parcel of that by saying
12 that somehow, as long as the Federal Government or
13 federal construction contracts bear the same cost in the
14 marketplace, that that's sufficient, the Federal
15 Government simply is protected against paying any more.

16 In our view, the decisions of this Court
17 convincingly refute that kind of relegation of the
18 immunity principle to what I might call a most favored
19 nation clause in a tariff treaty. This is an essential
20 part of the Constitution. It protects the Federal
21 Government from impairment of its functions by insisting
22 that those who deal with the Federal Government are not
23 singled out for discriminatory tax treatment.

24 We submit that the Court of Appeals decision,
25 the judgment should be affirmed.

1 CHIEF JUSTICE BURGER: Do you have anything
2 further, Mr. Attorney General?

3 REBUTTAL ARGUMENT OF KENNETH O. EIKENBERRY, ESQ.
4 ON BEHALF OF APPELLANTS, WASHINGTON, ET AL.

5 MR. EIKENBERRY: Yes, Mr. Chief Justice.

6 We submit that the test which this Court may
7 apply in this case is inherent in the Fresno case and
8 the Detroit case, and I would state it as follows: A
9 state may properly tax those doing business with the
10 Federal Government where the same tax is imposed on
11 comparable nonfederal situations and transactions, where
12 the same tax on those dealing with the United States is
13 no greater than the tax on nonfederal transactions. And
14 that's what we have here. In fact, the Federal
15 Government even has a cushion, if you will, because the
16 tax in the federal situation, the tax base is lower.

17 This test provides the United States not being
18 placed at a competitive disadvantage in carrying out its
19 functions, and it provides that those who are similarly
20 situated in other transactions will be treated alike.
21 It ensures, we believe also, that there will be a
22 political check, because this broad class has been
23 created and the taxes will therefore not be raised
24 abusively.

25 And that would conclude our argument, Your

1 Honor.

2 CHIEF JUSTICE BURGER: Thank you, gentlemen.

3 The case is submitted.

4 (Whereupon, at 10:50 a.m., the case in the
5 above-entitled matter was submitted.)

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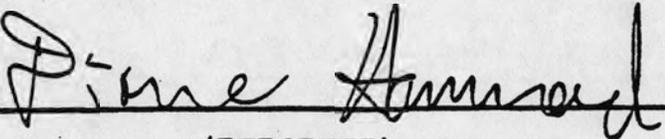
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Washington, Et Al., Appellants v. United States - No. 81-969

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