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UNITED STATES - CONTRACTS - EFFECT, WHEN TAX IS DECLARED UNCONSTITUTIONAL, OF PROVISIONS FOR INCREASE OR DECREASE OF PURCHASE PRICE FOR TAXES "IMPOSED" OR "CHANGED"

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UNITED STATES — CONTRACTS — EFFECT, WHEN TAX IS DECLARED UNCONSTITUTIONAL, OF PROVISIONS FOR INCREASE OR DECREASE OF PURCHASE PRICE FOR TAXES "IMPOSED" OR "CHANGED" — Between May 1935 and January 1936 the federal government purchased flour from respondent

through contracts which contained a so-called "up and down" tax clause.[1] The basic price charged included the A.A.A. processing taxes. During this same period respondent obtained an injunction against the collection of said processing taxes and, as a result of the decision of the Supreme Court in *United States v. Butler*,[2] was relieved of liability for the tax. In a later suit brought by respondent in the Court of Claims to recover on other contracts, the government claimed a setoff for the amount of these taxes. Judgment having been entered for respondent, the government appealed. *Held*, reversed, since the passage of the "windfall" tax[3] by Congress constituted a "change" in existing processsing taxes within the contract provision. *United States v. Kansas Flour Mills Corp.*, (U. S. 1941) 62 S. Ct. 232.

The buyer of goods is usually unable to recover from the seller the amount of a tax which has been passed on to him even though the tax is subsequently changed, repealed, or declared unconstitutional under circumstances such that the seller is relieved of liability to the government.[4] However, there may be a recovery on a theory of quasi-contract provided the tax is added to the purchase price as a separate item[5] and the buyer has not shifted the burden to subsequent purchasers,[6] the buyer's payment being considered as having been made through mistake and the seller thereby unjustly enriched. The mere fact that there is an

[1] Each of the contracts provided: "Prices set forth herein include any Federal tax heretofore imposed by the Congress which is applicable to the material purchased under this contract. If any sales tax, processing tax, adjustment charge or other taxes or charges are imposed or changed by the Congress after the date set for the opening of the bid upon which this contract is based and made applicable directly upon the production, manufacture, or sale of the supplies covered by this contract, and are paid to the Government by the contractor on the articles or supplies herein contracted for, then the prices named in this contract will be increased or decreased accordingly, and any amount due the contractor as a result of such change will be charged to the Government and entered on vouchers (or invoices) as separate items." 62 S. Ct. 232 at 234.

[2] 297 U. S. 1, 56 S. Ct. 312 (1935).

[3] 49 Stat. L. 1734, Revenue Act of 1936, Title III.

[4] See annotation in 115 A. L. R. 667 (1938) and cases there collected.

[5] Wayne County Produce Co. v. Duffy-Mott Co., 244 N. Y. 351, 155 N. E. 669 (1927). Recovery may be denied on the ground that payment was made under a mistake of law. Heckman & Co. v. I. S. Dawes & Son Co., 56 App. D. C. 213, 12 F. (2d) 154 (1926); Cohen v. Swift & Co., (C. C. A. 7th, 1938) 95 F. (2d) 131.

[6] Plaintiff must prove that the burden has not been shifted to subsequent purchasers. Moundridge Milling Co. v. Cream of Wheat Corp., (C. C. A. 10th, 1939) 105 F. (2d) 366; City Baking Co. v. Cascade Milling & Elevator Co., (D. C. Mont. 1938) 24 F. Supp. 950; and cases collected in 115 A. L. R. 667 (1938). Where the contract recites in the "up and down" clause that the price includes taxes, recovery has been allowed in spite of a composite price. United States v. American Packing & Provision Co., (C. C. A. 10th, 1941) 122 F. (2d) 445; United States v. Hagan & Cushing Co., (C. C. A. 9th, 1940) 115 F. (2d) 849. Cf. Lash's Products Co. v. United States, 278 U. S. 175, 49 S. Ct. 100 (1928). "Constructive trust" or "implied contract" are used interchangeably by the courts in these cases, though the basic theory of unjust enrichment is the same throughout. See also Johnson, "AAA Refunds: A Study in Tax Incidence," 37 COL. L. REV. 910 (1937), for an excellent evaluation of these doctrines in the light of the economic incidences of the taxes.

express contract may bar suit in quasi-contract.[7] Quasi-contract is thus ineffectual as a method of tax adjustment, since it depends on a purely fortuitous circumstance, the severance of the tax from the purchase price, and since it requires the almost impossible proof that the tax has not been passed on to others. To protect the buyer who has paid the tax against the danger of competition from tax-free goods and to protect the seller against increased taxation after he has already contracted to sell, parties have resorted to express provisions in the contract regarding taxes. The most common type, the so-called "up and down" clause, was extensively used in contracts affected by A.A.A. processing taxes. Where the buyer is a private party and the tax is later declared invalid, the courts have found the clause does not cover this contingency.[8] With these rules of interpretation as to private contract the court in the principal case expressly agrees. That the phrase "changes by Congress" is too narrow to include the case of invalidation by the Supreme Court is conceded.[9] However, because of the fact that a public contract is involved, the word "change" is given a broader interpretation. A tax which arguably was never "imposed" since void from its very inception,[10] but which certainly was no longer "imposed" after the decision in *United States v. Butler* is held nevertheless to have been "changed" by the later "windfall" tax. The Court is careful to limit this interpretation to government contracts; [11] hence a fortunate result is the stifling of further litigation

[7] Crete Mills v. Smith Baking Co., 136 Neb. 448, 286 N. W. 333 (1939); Sparks Milling Co. v. Powell, 283 Ky. 669, 143 S. W. (2d) 75 (1940). *Contra,* United States v. American Packing & Provision Co., (C. C. A. 10th, 1941) 122 F. (2d) 445; United States v. Hagan & Cushing Co., (C. C. A. 9th, 1940) 115 F. (2d) 849.

[8] Moundridge Milling Co. v. Cream of Wheat Corp., (C. C. A. 10th, 1939) 105 F. (2d) 366; Cohen v. Swift & Co., (C. C. A. 7th, 1938) 95 F. (2d) 131; Johnson Co. v. N. Sauer Milling Co., 148 Kan. 861, 84 P. (2d) 934 (1938); Sparks Milling Co. v. Powell, 283 Ky. 669, 143 S. W. (2d) 75 (1940); Crete Mills v. Smith Baking Co., 136 Neb. 448, 286 N. W. 333 (1939); Consolidated Flour Mills v. Ph. Orth Co., (C. C. A. 7th, 1940) 114 F. (2d) 898; and cases collected in 115 A. L. R. 667 (1938).

In Casey Jones, Inc. v. Texas Textile Mills, (C. C. A. 5th, 1937) 87 F. (2d) 454, a specific provision providing for the contingency that the tax be declared unconstitutional within ninety days was of no avail where 117 days passed between the sale and the decision in United States v. Butler, 297 U. S. 1, 56 S. Ct. 312 (1935). Cf. Continental Baking Co. v. Suckow Milling Co., (C. C. A. 7th, 1939) 101 F. (2d) 337.

The same conclusion was reached in the following cases involving public contracts: United States v. Hagan & Cushing Co., (C. C. A. 9th, 1940) 115 F. (2d) 849; Ismert-Hincke Milling Co. v. United States, 90 Ct. Cl. 27 (1939); Kansas Flour Mills Corp. v. United States, 92 Ct. Cl. 390 (1941); United States v. American Packing & Provision Co., (C. C. A. 10th, 1941) 122 F. (2d) 445. These cases are all expressly overruled by the principal case.

[9] Principal case, 62 S. Ct. 232 at 236.

[10] See concurring opinion of Wilbur, circuit judge, in United States v. Hagan & Cushing Co., (C. C. A. 9th, 1940) 115 F. (2d) 849.

[11] "The government stood in a dual relation to the respondent. It became, at the same time, a purchaser at the named price and also a claimant of the processing tax

over processing taxes by private parties. The result of the case seems correct on principles of unjust enrichment,[12] but the distinction between public and private contracts is difficult to justify.[13]

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upon the material purchased. The stipulation was evidently made in view of the facts that the purchasing officer could not buy the goods tax-free and that the Government desired that the price to it should be ex-tax. . . .

"In the contracts in question, the Government did not buy for resale. Unless it received the tax it suffered a definite disadvantage. Its purpose, as shown by the contracts, was to balance the tax element in the price paid with the tax collected. The government, which could not pass on the tax resale, was thus protected, not against a fall in the market price but against a loss in its tax revenues." Principal case, 62 S. Ct. 232 at 234, 235. These statements raise several interesting questions. Were the purchasing agents in fact as interested in tax collection as the Court supposes, or were they like private parties concentrating upon price adjustment? The cooperation between governmental departments is at least surprising. Was the disadvantage to the government from the loss of a tax to which it was not in any sense entitled any greater than the disadvantage to a private vendee who has not passed on the tax?

[12] In United States v. American Packing & Provision Co., (C. C. A. 10th, 1941) 122 F. (2d) 445, and the dissenting opinion of Healy, circuit judge, in United States v. Hagan & Cushing Co., (C. C. A. 9th, 1940) 115 F. (2d) 849, recovery was granted the government on principles of unjust enrichment. That the principles of unjust enrichment influenced the decision of the Court in the principal case is apparent in its justification of the moral right of the government to recovery, a pertinent factor in a suit for unjust enrichment but of secondary importance in the interpretation of an express contract. Of course if the purpose of the Court was to halt the endless litigation over processing taxes it has obviously succeeded.

[13] "In the case of private contracts, the vendees purchase for resale and the tax burden assumed is passed on to their customers." Principal case, 62 S. Ct. 232 at 235.

That this is not always true, due to economic factors, is shown by Johnson, "AAA Refunds: A Study in Tax Incidence," 37 COL. L. REV. 910 (1937). If the vendee in a private contract has not purchased for resale or has not passed on the tax, it would seem that he should also be allowed to recover.