

OPINION
67-290

May 2, 1967 (OPINION)

Honorable Edwin Sjaastad

Tax Commissioner

RE: Taxation - Sales tax - Construction contracts

This is in response to your letter in which you call attention to H.B. No. 943 which, amongst other things, amends and reenacts Section 3 of H.B. No. 731 and Section 1 of S.B. No. 403 of the Fortieth Legislative Assembly, relating to sales and use tax. The composite effect of such amendments produce the following result:

"In the case of a contract awarded for the construction of highways, roads, streets, bridges, and buildings prior to the effective date of this Act, the contractor receiving the award shall be liable only for the sales or use tax at the rate of tax in effect on the date of the contract."

In addition to amending sections in H.B. No. 731 and S.B. No. 403, H.B. No. 943 also enacts provisions of law by itself. The net result is the language as quoted above as it appears in the sales and use tax act. It uses the term "sales tax" and the term "use tax," or both, depending on the tax involved in the sections. However, for the purpose of answering the questions submitted the language can be treated in a composite manner.

You ask whether or not this provision is constitutional under the United States Constitution, Section 1, Article XIV, and Section 20 of the North Dakota Constitution, and Section 69, Clause 23, of the North Dakota Constitution. You also ask a number of other questions which are set forth later herein.

Prior to the amendment by H.B. No. 943, the language in H.B. No. 731 and S.B. 403 provided as follows:

"Any contract awarded prior to the effective date of this Act, the contractor receiving the award, shall be liable only for the sales or use tax at the rate of tax in effect on the date of the contract."

It can readily be observed that the exclusion under the amended language is more restrictive, limited and confined than the original language quoted above. The amendment clearly evidences an intent by the Legislature to limit, confine and restrict the exclusion as provided for in the amendment.

As to the constitutionality of the exclusion provision, under Section 69, Clause 23, of the North Dakota Constitution, we find that it is not a local law as same is defined in *State v. First Bank of Judd*, 52 N.D. 231, 202 N.W. 391, and *State ex rel. Atkins v. Lawler*, 53 N.D. 278, 205 N.W. 880. Neither is it a special law as defined by the same court in the above cases. The law applies throughout North

Dakota and is general to the extent that it applies to contracts pertaining to highways, streets, etc., entered into before the effective date of the Act. It establishes a class and applies to the entire class. Neither do we believe that the exclusion is invalid under Section 1 of Article XIV of the United States Constitution. All in the same class are treated equally and the law applies to each in the same manner. Neither do we believe that the classification is unreasonable. (*Gasson v. Gay*, 49 So.2d. 525, 21 A.L.R. 2d. 412.) This is an excise tax - not an ad valorem tax, consequently the question of uniformity does not have the same force and effect as provided for in the Constitution. For that matter, the North Dakota Constitution is relatively silent as pertaining to excise taxes. For this reason we believe that the provisions of this Act are not invalid under the provisions of Section 69, Clause 23, of the North Dakota Constitution.

We must also consider the constitutional provisions of Section 10, Article I of the United States Constitution, which prohibits the amendment of a law which would impair the obligations of contracts. This section, however, does not prohibit the State from imposing an excise tax. The Legislature has a right to exempt or exclude from the sales tax without any constitutional limitations. The cases on this are replete. (21 A.L.R. 2d., 412, 415.)

Due process and impairment of obligations of contracts are closely related. It has been held that one who, after the effective date of the statute, purchases property contracted to be purchased under an agreement executed prior to that date was unconstitutionally deprived of his property without due process under the sales tax Act when tangible personal property was sold at retail under a contract made prior to the effective date of the Act. (79 Pac. 2d. 380.) The courts have also held that the imposition of the tax on retail sales after the effective date of the Act, even though the sales were consummated pursuant to a contract executed prior thereto fixed the price of the merchandise, was not invalid.

We believe that the Legislature recognized the unfairness in this instance where the contract had been let to build roads or buildings for a set amount, but the contractor had not yet purchased the materials and under such instances the contractor would have to absorb the difference in the tax. We presume, to eliminate the questions of due process, and the impairment of obligation of contracts and the inequities resulting therefrom, that the Legislature provided for the exclusion.

It also appears that case law has not yet firmly answered all the questions and it will probably require further judicial determination before definite guidelines can be fully recognized, particularly under what conditions an excise tax may or may not impair the obligations of a contract.

We are also mindful that under the North Dakota Constitution all acts are presumed to be valid and that it takes four out of five Supreme Court Justices to declare an act invalid. On the basis of the foregoing, it is our opinion that the act is valid.

The sales or use tax is a tax on the consumer. This is the basic

concept throughout the tax laws even though the method of collection has some variance. This concept urges the conclusion that the exemption or exclusion given to a contractor refers to those contractors which are the consumers. The tax is on the consumer but is collected and remitted by the retailer. We do not believe that the provision in question applies to contractors who act in the capacity of a retailer. The provision applies only to the consumer contractor. We also believe that the term "contractor" applies to all who come within the term, whether they be private or public.

As to the terms "highway", "road" and "street", we are inclined to accept the meanings of such terms as normally applied to them. Such terms, unless otherwise qualified or modified, mean "public highways, roads or streets." This is particularly true of the terms "highways" and "streets." Because of the term "road" used in conjunction with highways and streets and it is not modified by any other adjective such as private, we assume that said term is used to mean a public road. We also assume that the Legislature used these terms as synonyms.

The term "bridge" takes its full color of meaning from other terms. We would therefore assume that such term refers to "public bridges." However, we do not believe that a bridge necessarily has to be on a highway, street or road, or that the Legislature intended to limit the term "bridge" to apply only to construction of same with a road, street or highway. The term "bridge" would include a railroad bridge.

The term "building" without any modification, means any building, public or private. We therefore conclude that any building, whether it be public or private, could come within the exclusion. However, as mentioned earlier, the contractor must be the user or consumer before the exclusion thereof. We believe that the exclusion was intended to cover only such items as went into or go into the construction of a road, street, highway, bridge or building. We do not believe that it includes items such as equipment used by the contractor to construct something. For example, a tractor, truck or other hauling conveyance would not come within the exclusion, while equipment such as a furnace, etc., which will be installed and become part of a building would come within the exclusion. The items which are used up or consumed in the construction come within the exclusion. By way of explanation, any piece of equipment, even though it is worn out in the construction of a road, street, etc., would still not be included in the exclusion. The exclusion applies only to such contracts where the contractor furnishes all of the material and items to produce a finished product at a given price. Where the owner pays for the material or items on a piecemeal basis or separately, and the contractor is paid to install them, then the items would no longer come within the exclusion.

You set forth the following questions:

"A. CONSTITUTIONALITY.

"QUESTION A-1: Does any one or more of the situations occurring under this provision of H.B. No. 943 that are detailed in subparagraphs a. and b. below constitute such an

arbitrary classification of tax rates, or of sales, or of contracts, or of retailers, or of contractors, or of final users or consumers that it violates the equal protection clause or the privileges and immunities clause or the due process clause of Section 1 of Article XIV of the United States Constitution, or the privileges and immunities clause of Section 20 of the North Dakota Constitution, or the requirement of Section 11 of the North Dakota Constitution that 'All laws of a general nature shall have a uniform operation', or the provision of Section 69, Clause 23, of the North Dakota Constitution which prohibits the legislative assembly from passing special laws 'For the assessment or collection of taxes'?

- a. Differences in tax rates, that is, 2 percent or 0 percent or 3 percent on communication services if within this provision of H.B. No. 943 and 2 percent or 2 1/4 percent or 3 percent on all other taxable transactions?
- b. Different tax rates that may apply to separate retail sales of the same kind of item when sold by
 - 1) The same retailer to the same contractor for use under different contracts?
 - 2) The same retailer to two different contractors?
 - 3) The same retailer to a contractor and a non-contractor?
 - 4) Different retailers to the same contractor?
 - 5) Different retailers to different contractors?
 - 6) Different retailers, one selling to a contractor and the other to a non-contractor?

"QUESTION A-2: If a contract entered into before April 1, 1967, for the construction of a project such as an airfield or runways on an airfield, or a water tower, or a telephone or electric power transmission line, or a radio or television transmission tower, or a railroad, or a dam is not a contract for the construction of a highway, road, street, bridge or building within the meaning of this provision of H.B. No. 943, does this constitute such an arbitrary classification that it violates the equal protection clause of the Constitution?

"B. TYPES OF CONTRACTS INCLUDED.

As to the determination of the types of contracts included in the scope of the provision of H.B. No. 943, it is necessary to know whether this provision is limited to contracts that add improvements to real property or whether it includes any contracts awarded for furnishing personal property or services in connection with the construction of highways, roads, streets, bridges and buildings. It is also necessary to know

the circumstances, if any, under which subcontractors are included in the provision. * * *

"QUESTION B-1: Does this provision of H.B. No. 943 apply to only those types of contracts under which the contractor is the final user or consumer of materials, supplies, machinery or equipment (or such of those items as are within the scope of this provision of H.B. No. 943) which he has agreed to both furnish and install into or incorporate into the real property of another? In other words, does this provision apply only to those kinds or types of contracts that are described in subparagraphs (a), (b) and (c) of sales and use tax rule No. 55 (a) on pages 34-35 of the Manual of 'North Dakota Sales and Use Tax Laws, Rules and Regulations' issued by the tax commissioner and dated July 1, 1961? * * *.

"QUESTION B-2: If this provision of H.B. No. 943 is not limited to the three types of contracts identified in the preceding question, what other types of contracts are included?

"QUESTION B-3: Does this provision of H.B. No. 943 include contracts that contractors entered into with

- a) private persons including business corporations?
- b) private nonprofit organizations?
- c) federal, state or local units of government?

"QUESTION B-4: Is a subcontractor a contractor within the meaning of this provision of H.B. No. 943 in the situation where the prime contractor was awarded the contract before April 1, 1967, but the subcontractor under him was not awarded the subcontract until after April 1, 1967?

"C. KINDS OF CONSTRUCTION.

"QUESTIONS C-1: Do the terms 'highways, roads, streets, bridges and buildings' as used in the provision of H.B. No. 943 that is in question here include any of the following:

- a. Privately owned highways, roads, streets, and bridges, assuming without necessarily concluding that a highway or street can be privately owned?
- b. Private driveways?
- c. Railroads, including the railroad bed or grade, ballast, rails and railroad ties, railroad bridges and signal devices?
- d. Water storage tanks, both elevated and underground?
- e. Underground water lines?
- f. Underground sewer lines and sewage disposal projects?

- g. Curb, gutter and sidewalks?
- h. Dams?
- i. Water wells, oil wells and gas wells?
- j. Electric power transmission lines, both elevated and underground?
- k. Gas lines for transporting natural or manufactured gas?
- l. Telephone and telegraph lines, both elevated and underground?
- m. Airfield runways?
- n. Radio or television transmission or relay towers?
- o. Street lighting (pole lamps)?

"QUESTION C-2: Does the construction of a building include the installation of machinery and equipment in a building pursuant to a contract?

"QUESTION C-3: Does the construction of a building include the installation of drapes and carpeting?

"QUESTION C-4: Does the 'construction' of a highway, road, street, bridge or building apply only to new construction or does it include rebuilding, renovation, remodeling, or repair, as the case may be, of an existing highway, road, street, bridge or building?

"D. KINDS OF MATERIALS AND SERVICES TO WHICH THE PROVISION IS APPLICABLE.

"QUESTION D-1: Does the provision of H.B. No. 943 apply to tangible materials physically incorporated into or installed in a highway, road, street, bridge or building?

"QUESTION D-2: Does this provision of H.B. No. 943 apply to various tangible items of equipment, tools, supplies, and so forth not physically incorporated into or installed in the highway, road, street, bridge or building but acquired by the contractor for use and consumption, in whole or in part, by him in performing the construction contract?

"QUESTION D-3: Does this provision of H.B. No. 943 apply to the utility services for telephone, water, electric light or power, and natural or manufactured gas purchased by the contractor for use at the construction site in completing the construction of a highway, road, street, bridge or building?

"QUESTION D-4: Does this provision of H.B. No. 943 apply to the utility services specified in Question D-3 used by a contractor at his central office or headquarters that are allocable under accepted accounting procedures to the

construction contract?

"Most, if not all, of the situations or problems described in the foregoing questions have already been presented to this department for a ruling as to the rate of tax to be applied. Because of this it was deemed advisable to submit these questions to you at one time so that the whole scope and meaning of his provision can be considered at the same time and so that a regulation interpreting it in accordance with your opinion can be drafted."

Because of the conclusions reached herein that the Act is valid, it becomes unnecessary to answer in further detail the questions submitted under the headings of A-1 and A-2.

As to question B-1 the exclusion applied only in instances where the contractor is the final user or consumer of the materials, supplies, machinery or equipment which he has agreed to both furnish and install into the finished product - the object of the contract. Such contract would clearly have to be limited to the type of contracts described in subparagraphs (a), (b) and (c) under Rule No. 55 (a) of the Sales and Use Tax Rules and Regulations, or a combination thereof.

As to QUESTION B-2 the answer to B-1 eliminates the necessity of answering same.

As to QUESTION B-3 the provisions in question (the exclusion paragraph) apply to all contracts whether they be public, private or governmental, but apply only to those projects or items named in the exclusion clause. This answer accordingly is modified by the answer given to QUESTION C-1.

As to QUESTION B-4 the contract entered into after April 1st would not be entitled to the exclusion. However, if the prime contractor is to furnish the material, equipment and machinery to be installed or incorporated into the finished product, the prime contractor is entitled to the exclusion in the same manner as he would be without having a subcontract. But, if the contract requires the subcontractor to obtain material, equipment, etc., on his own and the subcontract was entered after April 1st, he would not be entitled to the exclusion.

As to QUESTION C-1 the exclusion applies only to public highways, roads and streets, and to bridges and buildings. As to buildings, the exclusion applies whether they be private or public, but as to bridges, they would have to be for a public use even though they would not be considered publicly owned. It would not apply to private driveways, consequently the exclusion would not apply to those items listed under C-1 from a. through o., unless these items were incidental to the main project which comes within the exclusion and cannot be severed.

As to QUESTION C-2 the inclusion of machinery and equipment would depend whether same were included in the contract; that is, if the contractor contracted to construct a building with certain equipment or machinery in the building for a given or fixed price then it will come within the exclusion. However, if it is merely to install the

machinery or equipment in an existing building, it would not come within the exclusion.

As to QUESTION C-3 if the drapes or carpeting are an integral part of the building to be constructed and were included in the fixed price, then same would come within the exclusion but, if not, the answer is "no".

As to QUESTION C-4 we believe the term "construction" applies to any given situation where the improvement results in a major revision or modification of any highway, road or street. It would apply to situations where the highway is changed from a gravel to a blacktop or concrete, or from a trail to a graded road, or similar type of constructions. It would not apply to minor patchwork or repairs. Relocation in part would, of course, come within the term.

As to QUESTION D-1 tangible material which is in some form physically incorporated or installed in a highway, road or street comes within the exclusion.

As to QUESTION D-2 equipment, tools and supplies used by the contractor in performing the construction contract but not incorporated in the projects itself do not come within the exclusion.

As to QUESTION D-3 the utility services such as gas, telephone, electricity, etc., if such items can be clearly and distinctively identified as being used solely for the project for which the contract was awarded, the same can be considered within the exclusion.

As to QUESTION D-4 the utility services used at the central office or headquarters are not within the exclusion.

The foregoing answers are given without the benefit of any specific facts and consequently the answers are to be considered general in nature. It is conceivable that a specific set of facts could bring about a material conclusion or answer. We wish, however, to emphasize that the basic concept which was considered in arriving at the answers and which should be considered in other similar or related questions is that the exclusion applies only to such contractors who are their own consumers or users where the items concerned are incorporated or used in the finished product which was contracted for at a given fixed price. Where the contractor acts as a retailer in any capacity, the exclusion is not available to him.

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