MEMORANDUM OF LAW

DATE: March 27, 1990

TO: Roger C. Graff, Deputy Director, Engineering Division, Water Utilities Department

FROM: City Attorney

SUBJECT: Effect of Tax Increase on Pre-existing Contract

In a memorandum dated March 6, 1990, you asked this office for an opinion regarding the effect that a tax increase would have on the terms of a previously executed fixed price construction contract.

As I understand them, the facts are as follows: On October 6, 1989, The City of San Diego opened bids for construction of the Point Loma Treatment Plant Expansion (Bid No. 0251/89, Work Order No. 170071). Western Summit Constructors, Inc. (Summit) was determined to be the lowest responsible bidder on the project and was awarded the contract on November 21, 1989. Summit's base bid total was a fixed price of $12,210,000, and represented the sum of the fixed fees for the fourteen (14) project components.

Subsequent to the awarding of the contract to Summit, an increase in the California Sales Tax was implemented to generate revenue to assist with earthquake relief. An increase of one quarter percent (.25 percent) became effective on December 1, 1989. Summit now feels they are entitled to increased compensation from the City to offset the tax increase.

Summit's fixed price bid was based upon the City's Contract Specifications, which were submitted with Summit's bid. Section 2.04, paragraph 6(B) of the Contract Specifications provided in pertinent part, "bid prices shall include everything necessary for the completion of the work including but not limited to providing materials, equipment, tools, plant and other facilities, and the management, superintendence, labor and services. Bid prices shall include allowance for federal, state and local taxes." (Emphasis added.)

Although the tax rate is not specified, the language is clear as to which party bears the obligation to pay taxes. A condition precedent to the levying of a tax is the occurrence of the event which triggers the levy. In this case, "it is the purchase (or use) itself, not the signing of construction contracts ultimately

necessitating the purchase, which is the taxable event." John McShain, Inc. v. District of Columbia, 205 F.2d 882, 883 (D.C. Cir. 1953), cert. denied, 346 U.S. 900 (1953). Thus, it may be reasonably inferred that payment of the sales tax rate in effect at the time the goods or services are purchased, not the date the contract was signed, is the rate which Summit included in their bid.

A change in the tax rate is not an unforeseeable occurrence. Furthermore, "the imposition of a new tax, or the increase in the rate of an old one, is one of the usual hazards of business enterprise: seldom, if ever, does such an event impair the obligation of a pre-existing contract." Id.

In Western Contracting Corporation v. State Board of Equalization, 39 Cal. App. 3d 341, 352 (1974), the court stated, "Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of legal order . . . ." (Citation omitted.) Clearly, one of the essential attributes of sovereign power is the authority to increase or decrease taxes. Just as Summit would have realized a benefit from a decrease in the tax rate, so must they accept the burden of an increase.

For the reasons cited herein, it is our opinion that Summit is not entitled to additional compensation based upon the increase of one quarter percent (.25 percent) in the sales tax rate.

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Deputy City Attorney

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cc Hans Torabi
Associate Civil Engineer
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