

MEMORANDUM OF LAW

DATE: March 15, 1996

TO: Michael Andranovich, Services & Contracts Division,
Metropolitan Wastewater Department

FROM: City Attorney

SUBJECT: Contractor Claims for Sales and Use Tax Increases

This replies to your inquiry of February 15, 1996 wherein you transmitted a copy of a letter dated February 12, 1996 from Traylor Brothers, Inc./Obayashi Corporation, Joint Venture, the contractor for the South Bay Ocean Outfall Contract No. 2. In its letter, the contractor for this major project asserts that it has received notice of a 0.75% County Tax Rate increase which will become effective April 1, 1996. The contractor claims that it was not previously aware of this pending tax increase, and that the tax increase therefore "should be considered as a change to the contract, and should be handled as a reimbursable expense." You have asked for direction in responding to this letter.

First, it should be noted that the contractor misunderstands the notice regarding the so-called tax increase. In fact, there is no impending tax increase at all. Rather, the notice referred to by the contractor pertains to the end of a temporary tax rate rollback and tax credit program. The 0.75% tax rollback program in this county was the eventual result of a successful constitutional challenge to the collection of a special tax levied to fund a county jail. In *Rider v. County of San Diego*, 1 Cal. 4th 1 (1991), the California Supreme Court held that the county had been collecting the jail tax in violation of Proposition 13. The invalidly collected funds were in part refunded to taxpayers through a temporary tax rollback. Once the refund is complete, the tax rollback ends and reversion is made to the pre-existing tax rate. This should come as no surprise to the contractor, as the temporary nature of the tax rollback was public knowledge for years prior to the bid on the outfall contract.

Moreover, even if there truly was an impending tax increase in issue, there is a lack of authority to support the contractor's position that it is entitled to additional compensation. In fact, the contract is explicit that all taxes are to be paid by the contractor. Paragraph 6.13 of the General Provisions provides:

6.13 TAXES -- The CONTRACTOR shall pay all sales, consumer, use, and other similar taxes required to be paid in accordance with the Laws and Regulations of the place of the Project which are applicable during the performance of the Work. The City of San Diego is not exempt from sales tax. Emphasis added.

The emphasized language of this contract provision makes it clear that the contractor's responsibility to pay all taxes extends to all laws and regulations applicable during the performance period, not merely those which existed on the date bids were submitted. In light of this provision, the possibility for any increase in tax burden was a contingency assumed by the contractor in submitting its bid.

This is entirely consistent with the holding in *Western Contracting Corporation v. State Board of Equalization*, 39 Cal. App. 3d 341 (1974). That case involved interpretation of facts and contract provisions very similar to those presently in issue. The court observed that the sections of the contract covering the subject of "changed conditions" were confined to apply to changes in the work, not changes in the tax rate. The same reasoning extends to the "changed condition" provisions of the ocean outfall contract.

In consequence of the foregoing, it is recommended that you deny the Traylor Brothers/Obayashi claim on this issue.

JOHN W. WITT, City Attorney

By
Frederick M. Ortlieb
Deputy City Attorney

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cc William Hanley, III
MWWD Deputy Director