Belkin

**DECISION** THE COMPTROLLER GENERAL OF THE UNITED STATES 31826
WASHINGTON, D.C. 20548

**FILE:** B-215543 **DATE:** July 31, 1985

**MATTER OF:** Veterans Administration-Washington State Sales and Use Tax

**DIGEST:**

1. Reformation may be permitted on a case-by-case basis of fixed-price contracts between Veterans Administration and Washington State construction contractors which purported to include in contract price all applicable state taxes but did not include state sales and use taxes where both parties thought, due to erroneous assumptions of law, that these taxes which were not applicable at the time the contract was signed could not be imposed retroactively at a later time.

2. Even though some contractors may have executed a general release of all claims against the VA, based on the same mutual mistake of law, the release too may be reformed on a case-by-case basis to permit VA to reimburse contractors for state sales and use taxes retroactively assessed against them where it is clear that both parties expected VA to assume the costs of all applicable taxes.

This decision is in response to the letter dated October 31, 1984, from the Acting General Counsel of the Veterans Administration (VA) requesting our advice on whether it may reimburse its contractors for certain sales and use taxes for which the State of Washington is retroactively assessing them. These taxes were not thought to apply to contractors at the time contracts were awarded and therefore presumably were not included in their fixed-price bids. In 1983, the Supreme Court ruled that the taxes could constitutionally be imposed on contractors. Washington v. United States, 460 U.S. 536.

VA, in an earlier request on June 5, 1984, asked whether it could make a blanket reimbursement of all affected contractors under a theory of mutual mistake. We had declined to answer this question because the issues involved were then before the courts. See B-215543, September 11, 1984. The VA has now informed us that the District Court for the Western District of Washington dismissed the case on September 27, 1984, without resolving

the reimbursement issue. Therefore, VA resubmitted the matter to our Office on October 31, 1984, in accordance with its original request.

While a mutual mistake of law may well have occurred, our Office cannot approve of an across-the-board blanket reimbursement plan. However, we do not object, for the reasons given below, to reimbursement on a case-by-case basis if the VA is able to make the factual determination that a mutual mistake occurred and that each contractor claiming reimbursement did not include Washington State sales and use taxes in its bid.

**BACKGROUND**

On November 3, 1977, the United States District Court for the Western District of Washington State held that a state sales and use tax statute, as amended in 1975 to impose a sales tax on contractors who acquired materials for incorporation into Federal construction projects, discriminated against contractors who dealt with the United States since the statute did not impose a similar tax on non-Federal project contractors. The court found that this discriminatory tax violated the Supremacy Clause of the United States Constitution. Accordingly, the Court enjoined the State of Washington from continuing to assess and collect the tax and ordered the state to refund to the United States all sales taxes impermissibly collected from Federal contractors. In 1981, the Court of Appeals for the 9th Circuit affirmed the District Court's ruling. United States v. State of Washington, 654 F.2d 570 (9th Cir. 1981). The State of Washington appealed.

In Washington v. United States, 460 U.S. 536 (1983), the Supreme Court reversed the decision of both lower courts, and held that imposition of the Washington State sales and use tax on Federal contractors was not discriminatory and did not violate the Constitution since the statute imposed a similar tax directly on the property owners for all non-Federal construction projects. Pursuant to the Supreme Court's decision, the District Court, considering the case on remand, dissolved its injunction that had prohibited the State of Washington from collecting the tax from Federal contractors.

The State of Washington is now in the process of retroactively assessing the tax against Federal contractors for the period during which the injunction was in force. The specific question we have been asked to resolve is whether the VA "may reimburse Washington State contractors,

which in reliance on a Federal Court decision declaring the state tax unconstitutional, failed to include the tax in their bids."

While the injunction prohibiting collection of the tax was in effect, construction contracts used by VA contained the standard tax clause ordinarily used in construction contracts, which provided as follows:

> "(a) Except as may be otherwise provided in this contract, the contract price includes all applicable Federal, State, and local taxes and duties."

Based on that provision, the Justice Department's Office of Legal Counsel concluded that VA and other Federal agencies that employed the standard clause in their construction contracts, "are under no legal obligation to reimburse their contractors for the imposition of this tax on them." However, in a footnote, the Office of Legal Counsel noted that it had not considered whether a Federal contractor might, "because of a unique factual situation, later succeed against the Government in a particular contract action seeking rescission of the contract or reimbursement under some common law reformation of contract theory, such as mutual mistake."

VA's letter of June 5, 1984, suggests that reimbursement to all affected contractors, which presumably would be all those that entered into construction contracts with VA during the period the injunction was in effect, would be proper under a mutual mistake theory. In this respect, VA's letter reads as follows:

> "The position of the Washington State contractors is that the sales tax was not applicable during the pendancy of the injunction (from November 1977 until the decision) and therefore was not bid. It is clear that once the injunction was issued, the VA did not expect contractors to include the tax in their bids and did not allow the inclusion of the tax in any negotiated change orders. Our survey of contracting officials, however, does not indicate any specific instances where a contractor, competitively bidding on a project, was advised not to include the tax. The vast majority of VA contracting officials however were under the impression that the tax was not being included."

VA informed us that contruction contracts with Department of Defense (DOD) agencies operating in Washington State during this period contained a special clause directing contractors not to include the Washington State sales and use tax in their bid. Those contracts further provided that the contractors would be reimbursed for any state tax that was subsequently assessed against them. VA advised us that in April or May 1976 it had placed a similar clause on its "station" contracts that directed contractors not to include the tax in their bids and which agreed to "pay the contractors for any taxes which were ultimately assessed." After the District Court's ruling that the tax was unconstitutional, the clause was removed since "the VA considered the tax invalid as a result of the Court decision." VA never used a similar clause in its Office of Construction contracts.

**DISCUSSION**

A mutual mistake occurs when the contract, as written, does not reflect the actual agreement and true intention of the parties. See B-198515, June 23, 1981 and B-199049, August 7, 1980. The presence of the standard tax clause in the VA construction contracts which provided that the contract price included all "applicable federal, state, and local taxes" indicates that both parties to the contract intended the contract price to include any state taxes for which the contractor was liable. However, VA believed that the contractors were not liable for the sales and use taxes in question. VA says firmly that "once the injunction was issued, the VA did not expect contractors to include the taxes in their bids and did not allow the inclusion of the tax in any negotiated change orders." VA apparently never considered the effect of a reversal of both lower court decisions.

Similarly, in a letter we received from the Associated General Contractors of America, the contractors argue that while the District Court's injunction was in effect, the sales tax was "not applicable for bidding purposes because the state was not allowed to collect the tax * * *."

Both the VA and the contractors were correct in concluding that as of the time the bids were submitted to and accepted by VA, the sales and use taxes having been held unconstitutional and invalid by the two lower courts were not collectible. Ultimately, of course, the Supreme Court determined that the tax was valid. Since the decision by the Supreme Court had the effect of allowing the State of Washington to impose sales taxes "retroactively" on contractors who were awarded contracts during the period the injunction had been in effect, both the contractors who had not included the tax in their bids and the VA officials who did not believe the tax had been or should have been

included in the contract price proved to be mistaken. In other words, both parties to the contract made a mutual mistake of law. They apparently assumed, erroneously, either that the District Court's ruling, as affirmed, was final or else that even if the decision was overturned on appeal, as was the case, such a reversal would not have any impact on the applicability of the tax during the period the court injunction had been in force.

Certainly, it would have been preferable for the VA to have adopted a provision in its construction contracts similar to the one apparently used in the contracts of DOD agencies (and for a brief time in VA's "station" contracts) which directed contractors not to include the tax in their bids but which agreed to reimburse them for any state sales taxes that were subsequently assessed against them. However, VA's failure to use such a clause, as well as the contractors' failure to insist on its use, is completely consistent with the mistaken assumption both parties apparently made that even if the District Court's decision was reversed, the State of Washington could not retroactively impose sales taxes on the contractors.

In the past, our Office has allowed reformation of contracts when we were able to determine that the contract price failed to include state sales tax payable by the contractor due to a mutual mistake of law. See, B-186949, October 20, 1976; B-159064, May 11, 1966; and B-153472, December 2, 1965. For example, in B-180071, February 25, 1974, we allowed reformation after concluding that the parties to the contract had entered into the agreement "under the mistaken expectation" that the state sales and use tax was not applicable to contract performance.

The cases cited above in which reformation was allowed are different from the present case in one respect. They all involved situations in which a representative of the Government agency involved made a misrepresentation, albeit an innocent one, that the tax involved was not applicable. We granted reformation after we determined that the contractor had reasonably relied on that misrepresentation in failing to include the tax in its bid. While we recognize that that distinction may have some significance in a court of equity, we do not think that the difference should affect the result reached in this case. For one thing, none of those cases involved a situation in which the court had determined that the sales tax was unconstitutional and had issued an injunction prohibiting its collection.

As stated above, the essence of the mutual mistake theory is that the contract as written does not reflect the true intention and the actual agreement of the parties. See 30 Comp. Gen. 220 (1950). Since the contract clause which stated that the contract price included all "applicable" taxes demonstrates that both parties to the contract intended that the Government compensate the contractor for the cost of paying state and other taxes for which the contractor was responsible, we believe that any contract which, as a result of the confusion and misunderstanding generated by the issuance of the District Court's injunction, did not include in the price an amount representing state sales tax did not reflect the true intention of the parties and may be reformed.

However, we agree with the view expressed by the Justice Department's Office of Legal Counsel that the determination of whether a mutual mistake occurred in any of the individual contracts involved is a factual question that can only be resolved on a case-by-case basis. In the cases cited earlier, reformation was only allowed after a review of each record to determine that a mutual mistake had occurred and that the contractor claiming reimbursement in fact had not included the tax in its bid. See, for example, B-153472, December 2, 1965. Moreover, when mutual mistake is alleged, the standard of proof is a substantial one. For example, in B-197170, March 16, 1981, we said that the burden of proof rests on the party seeking reformation who must demonstrate through "clear and convincing" evidence that a mutual mistake occurred. See also 26 Comp. Gen. 899 (1947).

Therefore, we do not believe reformation would be proper here on an across-the-board or blanket basis without reviewing each contract to determine if a mutual mistake actually occurred. For example, it is certainly possible that when a particular contractor submitted its bid, it was either unaware of the existence of the District Court injunction or, even if aware, decided that the tax should be included anyway because the decision might be overturned and the tax retroactively imposed. Allowing reformation in these circumstances to add the tax again to contracts where it had already been included in the contract price would result in an improper and unauthorized windfall to the contractor involved.

Accordingly, if the VA is able to make the factual determination based on its review of the available records pertaining to a particular contract that the contractor failed to include sales tax in its bid due to a mutual mistake, we would not object to reformation of the contract

to provide for reimbursement by the VA to the contractor of any Washington State sales and use taxes that are ultimately assessed against the contractor.

Finally, since the contracts involved were entered into between 1977 and 1983, it is reasonable to assume that VA has already made final payment to many, if not most, of the contractors involved. Ordinarily, Government contracts provide that before final payment can be received, the contractor must execute a general release, but may specifically except from the effect of such release any continuing claims the contractor has against the Government under the contract. See Clark Mechancial Contractors, Inc. v. United States, 5 Cl.Ct. 84, 87 (1984). Assuming that a contractor who contracted with VA during the period in question executed such a release in connection with its receipt of final payment from VA, and did not note any specific exceptions for Washington State sales tax, the question arises as to whether the release would now bar a mutual mistake claim.

In G.M. Shupe, Inc. v. United States, 5 Cl.Ct. 662, 674 (1984), the Claims Court recognized that "where it is shown that by reason of a mutual mistake, neither party intended that the release cover a certain claim, the court will reform the release." As an example of such a situation in which reformation of the release would be allowed the Court described a situation in which the parties to a contract agreed that the contractor should

> " * * * be paid for state taxes on contract materials as part of the contract price and that after completion of the contract and execution of a release the state changed its laws and imposed taxes on the contractor."

Accordingly, we do not believe that a contractor would be barred from making a claim for reformation of the contract on the grounds of mutual mistake of law even if it had received final payment and had executed a general release. If VA is able to determine to its satisfaction that a mutual mistake of law occurred when the contract was entered into (which it must do if reformation is to be allowed), it is

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reasonable to assume that as a result of that same mistake, neither party intended that the release would cover state sales and use taxes which they did not know would become applicable to the contractors. Therefore, the release may also be considered to be amended.

for Shelton J. Doolan
Comptroller General
of the United States