



STATE BOARD OF EQUALIZATION

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State Controller

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Executive Director

May 18, 2012

Dear Interested Party:

Enclosed are the Agenda and Issue Paper for the May 30, 2012 Business Taxes Committee meeting. This meeting will address the proposed revisions to Audit Manual Chapter 4, *General Audit Procedures*.

Action 1 on the Agenda concerns the agreed upon proposed revisions to the audit manual to address the changes to the Federal Acquisition Regulation (FAR) and to clarify the application of tax on purchases of direct and indirect consumable supplies. Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m. on May 30, 2012** in Room 121 at the address shown above.

Sincerely,


for Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department

JLM: jmp

Enclosures

cc: Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. Robert Thomas, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichel, Board Member's Office, Third District

Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Kristine Cazadd
Mr. Randy Ferris
Ms. Christine Bisauta
Mr. Robert Tucker
Mr. Cary Huxsoll
Ms. Susanne Buehler
Ms. Kirsten Stark
Ms. Leila Hellmuth
Ms. Judi Pierce
Ms. Lynda Cardwell

AGENDA —May 30, 2012 Business Taxes Committee Meeting
Proposed revisions to Audit Manual Chapter 4 regarding US Government Supply Contracts and the Federal Acquisition Regulation (FAR)

<p>Action 1 — Agreed Upon Audit Manual Sections</p> <p>Sections 0411.00 through 0411.25 and Exhibits 10A through 10E.</p> <p>Issue Paper Exhibit 2.</p>	<p>Approve proposed revisions to Audit Manual Chapter 4 as agreed upon by staff and interested parties</p>
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Issue Paper Number **12-005**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposed Revisions to Audit Manual Chapter 4, *General Audit Procedures*

I. Issue

Should Audit Manual Chapter 4, *General Audit Procedures*, be simplified and updated to reflect the changes to Federal Acquisition Regulation (FAR)?

II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve proposed revisions to sections 0411.00 through 0411.25 and related exhibits, including new Exhibit 10E. These sections provide procedures for auditing United States Government supply contractors and were rewritten to do the following:

- Update the FAR references throughout the sections and exhibits,
- Revise and reorganize the sections to simplify and clarify content,
- Add a new section on audit procedures that addresses classified contracts, and
- Add a decision table, proposed Exhibit 10E, to assist the auditor in determining taxability based on the FAR clauses in a contract.

Mr. Joseph Vinatieri on behalf of the Aerospace Industries Association (AIA) agrees with staff's proposed revisions, attached as Exhibit 2.

III. Other Alternatives Considered

Do not revise the audit manual.

Issue Paper Number 12-005

IV. Background

FAR is the United States Government regulation governing the “acquisition process,” which is the process through which the government purchases goods and services, including the passage of title to the United States Government when purchasing goods from government supply contractors. FAR Parts 1 through 51 discuss policies and procedures and Part 52 provides the clauses that are inserted into contracts. FAR is updated regularly, but in 2007 there was a major rewrite of Part 45, *Government Property*, and the related clauses in Part 52.2, *Text of Provisions and Clauses*. Several government property clauses were combined into one clause.

Amendments to Regulation 1618, *United States Government Supply Contracts*, that incorporate the FAR revisions were discussed and authorized for publication by the Business Taxes Committee at the March 20, 2012 meeting. Procedures for auditing government supply contractors are included in Audit Manual sections 0411.00 through 0411.25 and Exhibits 10A through 10F. The audit manual sections discuss the application of tax to direct and indirect consumable supplies based on the type of contract (fixed price or cost-type) and the specific title clauses included in the contract.

Staff recommends the related audit manual sections in Chapter 4 be updated to reflect the current version of FAR. The text of relevant FAR sections is now provided in Exhibits 10A through 10D (replacing current Exhibits 10A through 10F). New Exhibit 10E provides a decision table to assist auditors in determining taxability based on FAR clauses in the contract. Staff met with interested parties on August 18, 2011, November 29, 2011, and January 17, 2012, to discuss and refine the proposed changes to the audit manual sections. The issue is scheduled for discussion at the May 30, 2012 meeting of the Business Taxes Committee.

V. Discussion

In general, under the Sales and Use Tax Law, if a product purchased for resale is used prior to being resold, tax is due on the use of the product and on the subsequent sale of the product. Although a sale to the United States Government is exempt under Revenue and Taxation Code section 6381, the purchase of the supplies used by a contractor in the performance of a United States Government supply contract may be subject to tax if title to the supplies does not pass to the United States Government prior to the contractor’s use of the supplies. Whether title to a given supply item passes to the United States Government, and whether it passes prior to the contractor’s use of it, depends on the title clauses in the contract, the type of contract, and the type of supply. If title passes prior to use of the item by the contractor, the contractor may purchase the item for resale. The subsequent sale to the United States Government is exempt from tax.

Currently, there are three standard FAR clauses that may pass title to the government; FAR 52.245-1, *Government Property*; FAR 52.232-16, *Progress Payments*; and FAR 52.232-32, *Performance-Based Payments*. The contract may also contain a custom clause to transfer title. United States Government supply contracts may be a cost-type contract, including cost reimbursement and time and material contracts, a fixed price contract, or a mixed contract that contains elements of both. A cost-type contract provides for reimbursement of allowable costs as prescribed per the contract, while a fixed price contract is for a set price. However, a fixed price contract may contain cost reimbursable elements.

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Staff and AIA agree that the audit manual should be revised to reflect the current provisions of FAR. As part of the revision, staff proposes reorganizing the sections for simplification and clarity. Because the time of title transfer may be difficult to determine, as it depends on the type of contract, the type of clause included in the contract, and the type of cost, staff proposes the manual sections be organized by these same categories. Staff also proposes including an easy to follow decision table as Exhibit 10E. Staff and AIA recommend revising the audit manual to clarify that title may pass to the United States Government prior to use under:

- FAR 52.245-1, *Government Property*, for cost-type contracts or cost-reimbursable contract line items in fixed price contracts.
- FAR 52.232-16, *Progress Payments*, for contracts with progress payments, or
- FAR 52.232-32, *Performance-Based Payments*, for contracts with performance-based payments.

According to discussions with a representative of the Defense Contract Management Agency (DCMA), if the contract provides for a specific type of payment, the contract will contain the related payment clause. However, there are additional forms of financing available to the contractor other than progress payments or performance-based payments. Staff has included clarification that not all financing provisions pass title to property prior to use as staff believes it is important to clarify that it is the progress payments clause and the performance-based payments clause that cause title to pass to the United States Government prior to use.

Staff and AIA also recommend revising the audit manual to incorporate a newly proposed section 0411.25, *Auditing Procedures*. The section incorporates staff's recently issued policy that presumes all cost-type contracts contain FAR 52.245-1, the government property clause, which passes title to the United States Government prior to use for cost reimbursement items. After discussing this matter with Mr. Vinatieri, members of AIA, and representatives from DCMA and Defense Contract Audit Agency (DCAA), the Sales and Use Tax Department revised its policy on auditing these contracts to presume that cost-type contracts, whether classified or not, contain the government property clause and, therefore, pass title prior to use for reimbursable line items. The new policy is supported by FAR 45.107, which provides that, "except as provided in paragraph (d) of this section, the contracting officer shall insert the clause at FAR 52.245-1, *Government Property*, in all cost reimbursement, time and material, and labor-hour type solicitations and contracts..." Paragraph (d) provides an exception for some purchase repair orders. (See Exhibit 2, Audit Manual section 0411.15.)

Staff and AIA also propose the new section provide a discussion on the forms and schedules that the contractor submits to the United States Government and how these forms and schedules may be used by the auditor to verify that items were resold to the United States Government prior to use.

VI. Alternative 1 - Staff Recommendation

Staff and AIA recommend the Board approve the proposed revisions to Audit Manual Chapter 4, *General Audit Procedures*, as reflected in Exhibit 2.

Issue Paper Number 12-005

A. Description of Alternative 1

The proposed revisions to Audit Manual Chapter 4, Sections 0411.00 – 0411.25 and Exhibits 10A – 10F:

- Update the FAR references throughout the sections.
- Revise and reorganize the sections to simplify and clarify content.
- Include a section on audit procedures for classified contracts.
- Change and renumber exhibits to reflect current FAR sections.
- Add a decision table to determine the correct application of tax when title transfers under a fixed price government supply contract. The table also notes the types of cost reimbursement contracts and highlights the nature of the title transfer.

B. Pros of Alternative 1

- Reflects current FAR provisions in the audit manual.
- Updates and simplifies discussion of United States Government supply contracts.
- Incorporates policy for auditing classified contracts.
- Provides an easy to understand decision table for the auditors to determine whether title to property passed to the United States Government prior to use in fixed price contracts.

C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

None.

E. Operational Impact of Alternative 1

Audit Manual revisions will be published on the BOE website.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the audit manual and the outreach efforts are considered routine. Any corresponding cost would be absorbed within the Board's existing budget.

2. Revenue Impact

None. See Exhibit 1.

G. Taxpayer/Customer Impact of Alternative 1

None.

H. Critical Time Frames of Alternative 1

None.

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VII. Other Alternative

A. Description of Alternative 2

Do not revise the audit manual.

B. Pros of Alternative 2

None.

C. Cons of Alternative 2

The audit manual will not reflect the current provisions of FAR or current policy on the review of classified contracts.

D. Statutory or Regulatory Change for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Exhibit 1.

G. Taxpayer/Customer Impact of Alternative 2

None.

H. Critical Time Frames of Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: May 14, 2012

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



Proposed Revisions to Audit Manual Chapter 4, *General Audit Procedures*

I. Issue

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II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve proposed revisions to sections 0411.00 through 0411.25 and related exhibits, including new Exhibit 10E. These sections provide procedures for auditing United States Government supply contractors and were rewritten to do the following:

- Update the FAR references throughout the sections and exhibits,
- Revise and reorganize the sections to simplify and clarify content,
- Add a new section on audit procedures that addresses classified contracts, and
- Add a decision table, proposed Exhibit 10E, to assist the auditor in determining taxability based on the FAR clauses in a contract.

Mr. Joseph Vinatieri on behalf of the Aerospace Industries Association (AIA) agrees with staff's proposed revisions.

III. Other Alternative Considered

Do not revise the audit manual.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in staff recommendation that would impact sales and use tax revenue. Staff recommendation only updates the FAR references throughout sections of the audit manual. In addition, staff's recommendation revises, reorganizes, simplifies, and clarifies sections of the audit manual. Finally, staff recommends a new section on audit procedures

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to address classified contracts; and adds a decision table to assist auditors in determining taxability based on FAR clauses in a contract.

Other Alternatives Considered

Alternative 2 – Do not amend the audit manual.

There is nothing in alternative 2 that would impact sales and use tax revenue.

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

Alternative 2 – alternative 2 does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Robert Ingenito, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of May 15, 2012.

Sections 0411.00 through 0411.25 and Exhibits 10A through 10F of Audit Manual Chapter 4 at <http://www.boe.ca.gov/sutax/manuals/am-04.pdf> are hereby deleted and replaced with Sections 0411.00 through 0411.25 and Exhibits 10A through 10E, as provided in this exhibit.

UNITED STATES GOVERNMENT SUPPLY CONTRACTS 0411.00

GENERAL 0411.05

The contract between the United States Government and the government supply contractor determines when title passes for property used in the performance of the contract. If title passes prior to use, the supply contractor may purchase the property for resale to the United States Government and the subsequent sale to the United States Government is exempt under section 6381 of the Revenue and Taxation Code. Exhibit 10E provides a decision table that may be used to assist the auditor in deciding if title to the property passes prior to use.

The United States Government established the Federal Acquisition Regulation (FAR) to set uniform policies and procedures for the acquisition of goods and services. Individual agencies may issue supplements to FAR that may supersede the current FAR if there is a conflict. Because of potential revisions to FAR and the agency supplements, contracts should be reviewed to determine what clauses are included. (See sections 0411.15 and 0411.25 for classified contracts exception.) Several of the standard definitions and clauses are included as Exhibit 10A. The FAR is accessible at <https://www.acquisition.gov/far/>. The auditor should check the website for current versions of applicable clauses.

Tangible personal property sold to or used by contractors in the performance of a contract with the United States Government to improve real property is not addressed in this section. The provisions of Regulation 1521, *Construction Contractors*, continue to govern the application of tax to such sales or use of tangible personal property.

TITLE CLAUSES 0411.10

Generally, title will transfer to the government under one of the following three FAR title clauses:

FAR 52.245-1, Government Property (Exhibit 10D)

The clause has different title passage provisions for fixed price contracts, cost reimbursement or time and material contracts, or cost reimbursement line items under fixed price contracts. In cost reimbursement or time and material contracts, or cost reimbursement line items in fixed price contracts, title passes prior to use for reimbursable items. In fixed price contracts, this clause will not pass title to items to the government unless the item is a deliverable or a cost-reimbursable contract line item. However, title to property may still pass to the government prior to use under one of the payments clauses. Also note that there is an alternate title clause for basic or applied research at nonprofit institutions of higher education or at nonprofit organizations whose primary purpose is the conduct of scientific research.

FAR 52.232-16, Progress Payments (Exhibit 10B)

Title passes at the date of the contract for property purchased prior to that date. Otherwise, title passes at the time the property is allocable or should have been allocable to the contract.

FAR 52.232-32, Performance-Based Payments (Exhibit 10C)

Title passes at the time of the first performance-based payment for property purchased prior to that date. Otherwise, title passes at the time property is allocable or should have been allocable to the contract. If title passes under this clause, there is the potential for use of the property prior to title passing to the United States Government for items purchased prior to the first payment. If there is a use prior to the first performance-based payment, the use by the contractor will generally be taxable.

In addition to the clauses described above, a contract could contain a title clause specific to that contract.

TYPES OF CONTRACTS 0411.15

The contract types are grouped into two broad categories: fixed-price contracts and cost-type contracts. The specific contract types range from firm-fixed-price, in which the contractor has full responsibility for the performance costs and resulting profit (or loss), to cost-plus-fixed-fee, in which the contractor has minimal responsibility for the performance costs and the negotiated fee (profit) is fixed. In between there are the various incentive contracts, such as flexibly-priced contracts, in which the contractor’s responsibility for the performance costs and the profit or fee incentives offered are tailored to the uncertainties involved in contract performance.

Cost Reimbursement Contracts

FAR 45.107 states cost-type contracts, including time and material contracts, shall contain FAR 52.245-1, the government property clause. The only exception is for purchase orders for property repair that do not meet the simplified acquisition threshold, generally set at \$150,000 based on FAR 2.101. Therefore, the auditor may presume that a cost-type contract, including a fixed price contract with cost-reimbursable contract line items, contains the government property clause. The auditor should consider materiality when deciding to review the contracts potentially falling under the property repair exemption.

Fixed Price Contracts

In fixed price contracts, the government property clause, FAR 52.245-1, passes title to contract deliverables and cost-reimbursable contract line items. In order to pass title to overhead supplies or consumables not directly provided for in the contract, the contract must contain either the progress payments clause or the performance-based payments clause described in section 0411.10. Fixed price contracts greater than \$2.5 million and contracts with qualifying small business concerns are eligible for contract financing and may contain either the progress payments clause or the performance-based payments clause. According to the Defense Contract Management Agency (DCMA), if progress payments are provided, the contract must contain the progress payment clause and if performance-based payments are provided, the contract must contain the performance-based payment clause. If the contract contains either clause, title would pass based on the provisions of the payment clause.

Flexibly Priced Contracts

A flexibly priced contract can be either a Fixed, Cost Reimbursement, or Time and Material contract. Passage of title is based on the type of contract and the FAR clauses noted in section 0411.10 that are included in the contract.

TYPES OF COSTS 0411.20

Direct Consumables

“Direct consumable supplies,” as defined by Regulation 1618, are those supplies which are consumed in the performance of a contract and are specifically identified to the contract and charged as a direct item of cost to the contract. In cost-type contracts, title transfers prior to use for reimbursable costs. However, in fixed price contracts, title passage under the government property clause is dependent on whether the cost is reimbursable and whether the contract has a provision directing the contractor to purchase the property as a direct item of cost.

Special tooling and special test equipment are generally treated in the same manner as other direct consumable supplies. The Progress Payments clause and the Performance-Based Payments clause pass title to that special tooling or special test equipment to which the Government will acquire title. According to DCMA, the Government will only finance the special tooling or special test equipment if it has acquired title to the special tooling or special test equipment. Therefore, once the Government finances the special tooling or special test equipment, the auditor may assume that the Government has acquired title to the property. If the contract contains either the Progress Payment clause or the Performance-Based Payment clause, title will pass according to the provisions of that clause.

Indirect Consumables

“Indirect consumable supplies” (overhead materials) are supplies consumed in the performance of a contract, the cost of which is charged to an overhead expense account and then allocated to various contracts based on generally accepted accounting principles. Title to indirect consumables will pass prior to use in cost reimbursement contracts, time and material contracts and cost-reimbursable line items in fixed price contracts. Otherwise, in order for title to pass prior to use, the contract must contain a financing payments clause and title will pass as provided for under that clause. For title to pass at the time provided under a contract’s payment clause, the contractor must allocate the overhead materials among the various commercial and qualifying and non-qualifying government contracts by means of a reasonable system of allocation which conforms to governing federal regulations and generally accepted accounting principles. One acceptable method is an allocation based on direct labor hours.

“Overhead materials” includes amounts recorded in cost accumulation pools that are allocated to qualifying and non-qualifying contracts including United States Government and commercial contract(s). Contractors may have Independent Research and Development (IRAD) and Bid and Proposal (B&P) accounts that accumulate costs for these two tasks. These costs are not taxable if (1) the purchased item is non-taxable (i.e. labor only, electronically delivered software, etc); or (2) a qualifying United States Government contract was in existence at the time of use and such costs were allocated to such contracts.

For example, bid and proposal expenses will be subject to tax if they include purchases of tangible personal property and are incurred at a time when no qualifying government contract was in existence. Some contractors may accumulate the IRAD and B&P costs in projects as if they were contracts. However, they are not contracts but costs.

Leases

In general, a lease of tangible personal property to a United States contractor is subject to tax whether or not such contractor is properly authorized to act as a purchasing agent of the United States. However, leases are exempt when they are (1) to contractors that occupy the legal status of agents of the United States and (2) to non-agent cost-plus federal contractors, other than Department of Defense contractors, that act as agents when procuring from General Services Administration (“GSA”) Supply Sources (“FSS” or “ADPS”) pursuant to a letter of authorization issued by a federal contracting officer which has language creating an agency relationship.

It has been the policy of the Department of Defense not to designate government contractors as legal agents of the United States. Therefore, a lease between a Department of Defense contractor and a vendor would not include the United States as a party to such lease, notwithstanding any FAR provision which attempts to characterize the buyer-lessee as an agent for the Department of Defense. Consequently, lease payments made by a Department of Defense contractor, which are charged as direct consumable supplies to a fixed price contract or cost reimbursement contract are subject to the sales or use tax.

Should a Department of Defense contractor nevertheless claim agency relationship with respect to a lease, the contractor is required to provide documentation to support such claim. The documentation should be submitted to the Chief, Tax Policy Division, with a copy to the Chief, Field Operations Division. The Chief, Tax Policy Division will communicate with the Secretary of Defense to ascertain the Department’s position with respect to the specific contract.

AUDITING PROCEDURES 0411.25

Classified or Proprietary Contracts

Based on federal regulations, the auditor may not view classified or proprietary contracts because they do not have sufficient security clearance. Generally, these types of contracts are cost-type contracts, including time and material contracts, and therefore are required to contain the government property clause. If the auditor can verify through other documentation that the contract is a cost reimbursement contract, a time and material contract or a fixed price contract with cost-reimbursable contract line items, the auditor may accept that the contract contains the government property clause without reviewing the actual contract.

The supply contractor is required to submit their costs to the government on a form, often called the Incurred Cost Schedule, listing the contract number, type of contract (cost, fixed, etc), and a summary of the costs. The auditor may be able to identify the type of contract by this form which is subject to disclosure and available for the auditor’s review. This form may have different names, but relates to the Indirect Cost document that is provided by the Contractor to Defense Contract Audit Agency (DCAA) / Defense Contract Management Agency (DCMA) on an annual basis. The guidelines for the document and a sample are available at <http://www.dcaa.mil/chap6.pdf>.

If the contract is a fixed price contract, the auditor cannot assume that title passes prior to use. The auditor should verify that the contract contains a clause that passes title prior to use, as described in section 0411.10, before accepting that the sales qualify as exempt sales to the United States Government. However, the auditor may explore alternative audit methods that determine, with the least possible expenditure of time, the correct amount of tax due.

Regardless of the type of contract, staff must develop a comprehensive understanding of the internal accounting practices of the United States Government contractor under audit, including the accounting system, cost flows, and internal controls. Review of the Government Contractor’s Disclosure Statement, which is reviewed by DCAA on an annual basis to verify adherence to accounting practices identified in the Disclosure Statement may help the auditor gain an understanding of the contractor’s records. The auditor must be able to verify that the supplies and goods purchased for resale to the United States Government are in fact resold or that tax has been paid on the purchase price. On a test basis, the auditor should trace the posting of the purchases to an overhead account, verify the allocation method, and confirm the submission of the cost to the United States Government. For example, the auditor could identify the accounting pool associated with the overhead account to which the purchase was charged and review the Incurred Cost Schedule (submitted to DCAA on an annual basis) to verify the pool’s allocation to the Government contracts.

EXHIBIT 10A

**FEDERAL ACQUISITION REGULATIONS (FAR’S) CLAUSE DEFINITIONS
FAR CLAUSE DEFINITIONS**

2.101. Definitions

“Direct cost” means any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

“Indirect cost” means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

“Special test equipment” means either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. It consists of items or assemblies of equipment including foundations and similar improvements necessary for installing special test equipment, and standard or general purpose items or components that are interconnected and interdependent so as to become a new functional entity for special testing purposes. Special test equipment does not include material, special tooling, real property, and equipment items used for general testing purposes or property that with relatively minor expense can be made suitable for general purpose use.

“Special tooling” means jigs, dies, fixtures, molds, patterns, taps, gauges, and all components of these items including foundations and similar improvements necessary for installing special tooling, and which are of such a specialized nature that without substantial modification or alteration their use is limited to the development or production of particular supplies or parts thereof or to the performance of particular services. Special tooling does not include material, special test equipment, real property, equipment, machine tools, or similar capital items.

45.101 Definitions

“Contractor-acquired property” means property acquired, fabricated, or otherwise provided by the contractor for performing a contract and to which the Government has title.

“Equipment” means a tangible item that is functionally complete for its intended purpose, durable, nonexpendable, and needed for the performance of a contract. Equipment is not intended for sale, and does not ordinarily lose its identity or become a component part of another article when put into use. Equipment does not include material, real property, special test equipment or special tooling.

“Government-furnished property” means property in the possession of, or directly acquired by, the Government and subsequently furnished to the contractor for performance of a

contract. Government-furnished property includes, but is not limited to, spares and property furnished for repair, maintenance, overhaul, or modification. Government-furnished property also includes contractor-acquired property if the contractor-acquired property is a deliverable under a cost contract when accepted by the Government for continued use under the contract.

“Government property” means all property owned or leased by the Government. Government property includes both Government-furnished property and contractor-acquired property. Government property includes material, equipment, special tooling, special test equipment, and real property. Government property does not include intellectual property and software.

“Material” means property that may be consumed or expended during the performance of a contract, component parts of a higher assembly, or items that lose their individual identity through incorporation into an end-item. Material does not include equipment, special tooling, special test equipment or real property.

EXHIBIT 10B

FEDERAL ACQUISITION REGULATIONS (FAR’S) PROGRESS PAYMENTS
CODE OF FEDERAL REGULATIONS
TITLE 48
FEDERAL ACQUISITION REGULATIONS SYSTEM
52.232-16 (d)
Progress Payments

52.232-16 Progress Payments.

As prescribed in [32.502-4\(a\)](#), insert the following clause:

PROGRESS PAYMENTS (APR 2012)

(d) Title.

(1) Title to the property described in this paragraph (d) shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.

(2) “Property,” as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable or properly chargeable to this contract under sound and generally accepted accounting principles and practices.

(i) Parts, materials, inventories, and work in process;

(ii) Special tooling and special test equipment to which the Government is to acquire title;

(iii) Nondurable (*i.e.*, noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under paragraph (d)(2)(ii) of this clause; and

(iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver them to the Government by other clauses of this contract.

(3) Although title to property is in the Government under this clause, other applicable clauses of this contract; *e.g.*, the termination clauses, shall determine the handling and disposition of the property.

(4) The Contractor may sell any scrap resulting from production under this contract without requesting the Contracting Officer’s approval, but the proceeds shall be credited against the costs of performance.

(5) To acquire for its own use or dispose of property to which title is vested in the Government under this clause, the Contractor must obtain the Contracting Officer’s advance approval of the action and the terms. The Contractor shall (i) exclude the allocable costs of the property from the costs of contract performance, and (ii) repay to the

Government any amount of unliquidated progress payments allocable to the property. Repayment may be by cash or credit memorandum.

(6) When the Contractor completes all of the obligations under this contract, including liquidation of all progress payments, title shall vest in the Contractor for all property (or the proceeds thereof) not—

(i) Delivered to, and accepted by, the Government under this contract; or

(ii) Incorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.

(7) The terms of this contract concerning liability for Government-furnished property shall not apply to property to which the Government acquired title solely under this clause.

EXHIBIT 10C

FEDERAL ACQUISITION REGULATIONS (FAR’S) PERFORMANCE-BASED
PAYMENTS
CODE OF FEDERAL REGULATIONS
TITLE 48
FEDERAL ACQUISITION REGULATIONS SYSTEM
52.232-32 (f)
Performance-Based Payments

52.232-32 Performance-Based Payments.

As prescribed in [32.1005](#), insert the following clause:

PERFORMANCE-BASED PAYMENTS (APR 2012)

(f) Title.

(1) Title to the property described in this paragraph (f) shall vest in the Government. Vestiture shall be immediately upon the date of the first performance-based payment under this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.

(2) “Property,” as used in this clause, includes all of the following described items acquired or produced by the Contractor that are or should be allocable or properly chargeable to this contract under sound and generally accepted accounting principles and practices:

(i) Parts, materials, inventories, and work in process;

(ii) Special tooling and special test equipment to which the Government is to acquire title;

(iii) Nondurable (*i.e.*, noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment and other similar manufacturing aids, title to which would not be obtained as special tooling under paragraph (f)(2)(ii) of this clause; and

(iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver them to the Government by other clauses of this contract.

(3) Although title to property is in the Government under this clause, other applicable clauses of this contract (*e.g.*, the termination clauses) shall determine the handling and disposition of the property.

(4) The Contractor may sell any scrap resulting from production under this contract, without requesting the Contracting Officer’s approval, provided that any significant reduction in the value of the property to which the Government has title under this clause is reported in writing to the Contracting Officer.

(5) In order to acquire for its own use or dispose of property to which title is vested in the Government under this clause, the Contractor shall obtain the Contracting Officer’s advance approval of the action and the terms. If approved, the basis for payment (the events or performance criteria) to which the property is related shall be deemed to be not in compliance with the terms of the contract and not payable (if the property is part of or needed for performance), and the Contractor shall refund the related performance-based payments in accordance with paragraph (d) of this clause.

(6) When the Contractor completes all of the obligations under this contract, including liquidation of all performance-based payments, title shall vest in the Contractor for all property (or the proceeds thereof) not—

(i) Delivered to, and accepted by, the Government under this contract; or

(ii) Incorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.

(7) The terms of this contract concerning liability for Government-furnished property shall not apply to property to which the Government acquired title solely under this clause.

EXHIBIT 10D

FEDERAL ACQUISITION REGULATIONS (FAR’S) GOVERNMENT PROPERTY (FIXED PRICE CONTRACTS)
CODE OF FEDERAL REGULATIONS
TITLE 48
FEDERAL ACQUISITION REGULATIONS SYSTEM
52.245-1 (a) and (e) and Alternate II
Government Property

52.245-1 Government Property.

As prescribed in [45.107\(a\)](#), insert the following clause:

Government Property (Apr 2012)

(a) *Definitions.* As used in this clause—

“Cannibalize” means to remove parts from Government property for use or for installation on other Government property.

“Contractor-acquired property” means property acquired, fabricated, or otherwise provided by the Contractor for performing a contract, and to which the Government has title.

“Contractor inventory” means—

(1) Any property acquired by and in the possession of a Contractor or subcontractor under a contract for which title is vested in the Government and which exceeds the amounts needed to complete full performance under the entire contract;

(2) Any property that the Government is obligated or has the option to take over under any type of contract, *e.g.*, as a result either of any changes in the specifications or plans thereunder or of the termination of the contract (or subcontract thereunder), before completion of the work, for the convenience or at the option of the Government; and

(3) Government-furnished property that exceeds the amounts needed to complete full performance under the entire contract.

“Contractor’s managerial personnel” means the Contractor’s directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of—

(1) All or substantially all of the Contractor’s business;

(2) All or substantially all of the Contractor’s operation at any one plant or separate location; or

(3) A separate and complete major industrial operation.

“Demilitarization” means rendering a product unusable for, and not restorable to, the purpose for which it was designed or is customarily used.

“Discrepancies incident to shipment” means any differences (*e.g.*, count or condition) between the items documented to have been shipped and items actually received.

“Equipment” means a tangible item that is functionally complete for its intended purpose, durable, nonexpendable, and needed for the performance of a contract. Equipment is not intended for sale, and does not ordinarily lose its identity or become a component part of another article when put into use. Equipment does not include material, real property, special test equipment or special tooling.

“Government-furnished property” means property in the possession of, or directly acquired by, the Government and subsequently furnished to the Contractor for performance of a contract. Government-furnished property includes, but is not limited to, spares and property furnished for repair, maintenance, overhaul, or modification. Government-furnished property also includes contractor-acquired property if the contractor-acquired property is a deliverable under a cost contract when accepted by the Government for continued use under the contract.

“Government property” means all property owned or leased by the Government. Government property includes both Government-furnished and Contractor-acquired property. Government property includes material, equipment, special tooling, special test equipment, and real property. Government property does not include intellectual property and software.

“Loss of Government property” means unintended, unforeseen or accidental loss, damage or destruction to Government property that reduces the Government’s expected economic benefits of the property. Loss of Government property does not include purposeful destructive testing, obsolescence, normal wear and tear or manufacturing defects. Loss of Government property includes, but is not limited to—

- (1) Items that cannot be found after a reasonable search;
- (2) Theft;
- (3) Damage resulting in unexpected harm to property requiring repair to restore the item to usable condition; or
- (4) Destruction resulting from incidents that render the item useless for its intended purpose or beyond economical repair.

“Material” means property that may be consumed or expended during the performance of a contract, component parts of a higher assembly, or items that lose their individual identity through incorporation into an end item. Material does not include equipment, special tooling, special test equipment or real property.

“Nonseverable” means property that cannot be removed after construction or installation without substantial loss of value or damage to the installed property or to the premises where installed.

“Precious metals” means silver, gold, platinum, palladium, iridium, osmium, rhodium, and ruthenium.

“Production scrap” means unusable material resulting from production, engineering, operations and maintenance, repair, and research and development contract activities. Production scrap may have value when re-melted or reprocessed, *e.g.*, textile and metal clippings, borings, and faulty castings and forgings.

“Property” means all tangible property, both real and personal.

“Property Administrator” means an authorized representative of the Contracting Officer appointed in accordance with agency procedures, responsible for administering the contract requirements and obligations relating to Government property in the possession of a Contractor.

“Property records” means the records created and maintained by the contractor in support of its stewardship responsibilities for the management of Government property.

“Provide” means to furnish, as in Government-furnished property, or to acquire, as in contractor-acquired property.

“Real property” See Federal Management Regulation 102-71.20 (41 CFR 102-71.20).

“Sensitive property” means property potentially dangerous to the public safety or security if stolen, lost, or misplaced, or that shall be subject to exceptional physical security, protection, control, and accountability. Examples include weapons, ammunition, explosives, controlled substances, radioactive materials, hazardous materials or wastes, or precious metals.

“Unit acquisition cost” means—

(1) For Government-furnished property, the dollar value assigned by the Government and identified in the contract; and

(2) For contractor-acquired property, the cost derived from the Contractor’s records that reflect consistently applied generally accepted accounting principles.

(e) Title to Government property.

(1) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as “Government property”), is subject to the provisions of this clause. The Government shall retain title to all Government-furnished property. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(2) Title vests in the Government for all property acquired or fabricated by the Contractor in accordance with the financing provisions or other specific requirements for passage of title in the contract. Under fixed price type contracts, in the absence of financing provisions or other specific requirements for passage of title in the contract, the Contractor retains title to all property acquired by the Contractor for use on the contract, except for property identified as a deliverable end item. If a deliverable item is to be retained by the

Contractor for use after inspection and acceptance by the Government, it shall be made accountable to the contract through a contract modification listing the item as Government-furnished property.

(3) Title under Cost-Reimbursement or Time-and-Material Contracts or Cost-Reimbursable contract line items under Fixed-Price contracts.

(i) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the vendor’s delivery of such property.

(ii) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon—

(A) Issuance of the property for use in contract performance;

(B) Commencement of processing of the property for use in contract performance;

or

(C) Reimbursement of the cost of the property by the Government, whichever occurs first.

Alternate II (*Apr 2012*). As prescribed in [45.107\(a\)\(3\)](#), substitute the following for paragraph (e)(3) of the basic clause:

(e)(3) Title to property (and other tangible personal property) purchased with funds available for research and having a unit acquisition cost of less than \$5,000 shall vest in the Contractor upon acquisition or as soon thereafter as feasible; provided that the Contractor obtained the Contracting Officer’s approval before each acquisition. Title to property purchased with funds available for research and having a unit acquisition cost of \$5,000 or more shall vest as set forth in this contract. If title to property vests in the Contractor under this paragraph, the Contractor agrees that no costs shall be allowed for any depreciation, amortization, or use under any existing or future Government contract or subcontract thereunder. The Contractor shall furnish the Contracting Officer a list of all property to which title is vested in the Contractor under this paragraph within 10 days following the end of the calendar quarter during which it was received. Vesting title under this paragraph is subject to civil rights legislation, [42 U.S.C. 2000d](#). Before title is vested and by signing this contract, the Contractor accepts and agrees that—

“No person in the United States or its outlying areas shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under this contemplated financial assistance (title to property).”

DECISION TABLE

EXHIBIT 10E

Fixed Price Contracts *				
	FAR Clause Inserted in Contract ¹			
	Government Property 52-245-1(e)(2)	Progress Payment 52.232-16(d)	Performance-Based Payment² 52.232-32(f)	Application of tax
Direct and Indirect Costs and Contract Deliverables if Used by the Contractor Prior to Delivery³	Y or N	N	N	Taxable
	Y or N	Y	N	Non-Taxable
	Y or N	N	Y	Non-Taxable
Cost Reimbursable Line Item in Contract	Y or N	Y or N	Y or N	Non-Taxable

¹ A contract may also contain a custom clause that transfers title.

² Title transfers after first performance payment. Milestone payments are a form of performance-based payments when the contract includes a performance-based payment clause.

³

- Tax is not due if there is no use of the deliverable prior to delivery
- Excludes contract reimbursable line items
- Includes special tooling and special test equipment, if financed by the Government.

* The table applies to Fixed Price Contracts. Other types of contracts include:

- **Cost reimbursement and time and material contracts:** Title passes prior to use for reimbursable direct and indirect (i.e., overhead materials) consumable supply costs.
- **Commercial Contracts:** These contracts are non-qualified contracts in the contractor’s rate calculation.
- **Independent Research and Development (IRAD) and Bid and Proposal (B&P):** Although some contractors may treat them as contracts, these are indirect consumable supply costs and are allocated to contracts similar to other reimbursable costs and not considered contracts.