

## **Tech BizSolutions Featured E-news Subject**

### **Exemption from Sales and Use tax under government grants and contracts**

It has been common practice for many Government contractors to not pay sales tax on purchases made for Federal Government contracts.

FAR 29.302 (a) states "Generally, purchases and leases made by the Federal Government are immune from State and local taxation. Whether any specific purchase or lease is immune, however, is a legal question requiring advice and assistance of the agency-designated counsel."

Thus, the question of the allowability of the cost of sales and use tax arises for a Government contractor or grantee.

FAR 31.205-41 (b) states "The following types of costs are not allowable: (3) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Government ..."

The Defense Contract Audit Agency (DCAA) in its Defense Contract Audit Manual (DCAM) at 7-1403.6 explains "For example, the Connecticut Supreme Court, applying Connecticut statutes, found that the United States is the actual buyer of personal property sold by third parties to a cost-reimbursement government contractor because the one who takes title to the property is the United States. It held such sales exempt from Connecticut sales tax."

#### **Shades of Gray**

This all leaves a contractor thinking that sales and use tax will not be allowed and should not be paid. However, the shades of gray in this area of cost allowability are numerous and, as a consequence, the DCAA's DCAM at 7-1403.6 further states, "Determinations of whether state and local taxes are allowable contract costs under FAR 31.205-41 must be made on a case-by-case basis based on each state's tax laws. Questions regarding state-law exemptions and federal sovereign immunity should be addressed to the contracting officer's designated legal counsel because they require interpretations ..."

FAR 29.303 -- Application of State and Local Taxes to Government Contractors and Subcontractors states, "(b) When purchases are not made by the Government itself, but by a prime contractor or by a subcontractor under a prime contract, the right to an exemption of the transaction from a sales or use tax may not rest on the Government's immunity from direct taxation by States and localities. It may rest instead on provisions of the particular State or local law

involved. . ." Further, this section of FAR states, "(c) Frequently, property (including property acquired under the progress payments clause of fixed-price contracts or the Government property clause of cost-reimbursement contracts) owned by the Government is in the possession of a contractor or subcontractor. Situations may arise in which States or localities assert the right to tax Government property directly or to tax the contractor's or subcontractor's possession of, interest in, or use of that property. In such cases, the contracting officer shall seek review and advice from the agency-designated counsel on the appropriate course of action."

FAR 29.101 -- Resolving Tax Problems states, "(c) When the constitutional immunity of the Government from State or local taxation may reasonably be at issue, contractors should be discouraged from negotiating independently with taxing authorities if the contract involved is either -- (1) A cost-reimbursement contract; or (2) A fixed-price contract containing a tax escalation clause."

#### **Colorado Case**

In the review of one of our clients, a State of Colorado sales tax auditor cited a 1991 Colorado court case of Colorado Regional Transportation District vs. Martin Marietta Corp (805P.2D 1102) in which "the court found that items purchased by a taxpayer for use in the performance of government contracts which were not incorporated into the final product to be taxable to the taxpayer making the purchase. These items were found to be taxable even if title immediately passed to the federal government per the contract." The final opinion asserted that the sales (use) tax should be paid.

The contracts performed by our client during that time period were SBIR contracts that required the delivery of a final report but not other hardware. As such, the company decided that the payment of the tax was appropriate. Our client has undergone an audit with the DCAA for those taxes that were paid and they were not questioned as allowable expenses. Also our client decided that city sales tax needed to be paid.

#### **The New Mexico case**

In New Mexico, the situation is more formalized for contractors based there. Contracts with the federal government contain the FAR clause 52.229-10 -- State of New Mexico Gross Receipts and Compensating Tax. Which states

in part "(b) The Contractor shall pay the New Mexico gross receipts taxes, pursuant to the Gross Receipts and Compensating Tax Act of New Mexico, assessed against the contract fee and costs paid for performance of this contract, or of any part or portion thereof, within the State of New Mexico. The allowability of any gross receipts taxes or local option taxes lawfully paid to the State of New Mexico by the Contractor or its subcontractors will be determined in accordance with the Allowable Cost and Payment clause of this contract except as provided in paragraph (d) of this clause."

### **Taxes in Texas**

In another example, a client of ours, based on our advice, called the state directly to discuss their particular situation. They reported to us that "the tax policy division for the State of Texas would not grant (our client) an exemption from sales tax for items purchased for the NIH grants. Their rules require any company that claims sales tax exemption be a non-profit organization as defined by the IRS." The state pointed out State law would also recognize a tax exemption for our client if it were an official federal government agency, "and we were not federal employees. We do not fit any of their criteria, so we will keep paying sales tax."

### **Conundrum**

So, is it confusing enough up to this point? What about purchases bought that are indirect cost and not direct cost to a contract? FAR 31.205-41 – Taxes states "(c) ... The cost of taxes incurred on property used in both Government and non- Government work shall be apportioned to all such work based upon the use of such property on the respective final cost objectives." Based on this type of direct statements in the FAR and general principles of cost allocability, our clients allocate the sales and use tax on purchases of indirect cost items based on their particular accounting systems design for allocation indirect cost to a contract.

### **Conclusion**

We think it is wise for our clients to call their state tax officials and contact their Contracting Officer about their particular situation. Clients should pay the sales tax now (if there is any doubt) while the contract has money rather than later when the contract is closed.

---

***Tech BizSolutions E-News is a feature of Tech BizSolutions, Inc. Let us know if you have other subjects you are interested in. Contact us at [info@techbizsolutions.com](mailto:info@techbizsolutions.com), or call 303-443-4440.***