

ARMY PROCUREMENT POLICY ALERT BULLETIN

NO. 98-010

August 26, 1998

The following documents contain the latest policy related to various acquisition topics. Immediate implementation and compliance with these policies is required.

1. DP/CPF Memorandum, Subject: Contractor Claims for Reimbursement of German Taxes, August 12, 1998. (See PPAB 98-008* for additional information on this topic).
2. DP/CPF Memorandum, Subject: Progress Payment Distribution, August 12, 1998.

*PPAB 98-008 can be found in the library at URL:
<http://www.acqnet.sarda.army.mil>

This bulletin is issued by the Office of the Deputy Assistant Secretary of the Army (Procurement). Comments or questions should be referred to Headquarters, Department of the Army, ATTN: SARD-PP, Skyline 6, Suite 916, 5109 Leesburg Pike, Falls Church, VA 22041-3201.

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ACQUISITION AND
TECHNOLOGY

DP/CPF

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

AUG 12, 1998

MEMORANDUM FOR DIRECTORS, DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT
ASN(RDA)/ABM
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
DEPUTY DIRECTOR (ACQUISITION), DEFENSE LOGISTICS
AGENCY

SUBJECT: Contractor Claims for Reimbursement of German Taxes

The United States and German governments recently concluded agreements on the interpretations of Articles 72 and 73 of the Supplementary Agreement to the NATO Status of Forces Agreement. The agreement on Article 72 provides criteria and procedures for determining whether contractor employees qualify as troop care personnel. The agreement on Article 73 provides a definition of technical expert and criteria for determining whether an individual meets that definition. Employees who qualify as troop care personnel or technical experts, and who are not ordinarily resident in Germany, are exempt from German taxation. Employees who do *not* qualify are subject to German taxation.

The primary types of German taxes levied on non-exempt employees and their employers include (1) employee income taxes, (2) the employee's share of social insurance contributions, and (3) the employer's share of social insurance contributions. Social insurance contributions include payments for retirement pay insurance, health insurance, unemployment insurance, nursing care insurance, and accident insurance.

Employees who do not qualify as troop care personnel or technical experts are subject to German taxation beginning January 1, 1997. In addition, these employees are subject to taxes for periods prior to January 1, 1997, if proceedings on grounds of wrongfully obtaining exemptions and benefits as technical experts were pending before German courts, public prosecutors' offices or authorities (but only to the extent these proceedings were known to the U.S. Forces, the contractor, or the employee prior to March 27, 1998). Thus, there will be instances where contractors and contractor employees are required to pay German taxes applicable to moneys earned in prior years. Questions have been raised regarding



the reimbursement of these retroactive (i.e., back) taxes on government contracts.

A decision to reimburse or not reimburse contractors for German back taxes should be made by the Contracting Officer on a case-by-case basis considering all pertinent facts and circumstances and after consultation with legal counsel. The attachment to this memorandum provides general guidance to assist the Contracting Officer in making that decision.

If you have any questions concerning this memorandum, please contact Mr. David Capitano at (703)695-9764.



Eleanor R. Spector
Director, Defense Procurement

Attachment

GENERAL GUIDANCE

Employee Income Taxes

Individual employee income taxes are based on the salaries and wages of each employee. The tax is withheld by the contractor from the employees' gross salaries and wages. The tax is similar to the income taxes individual employees' pay based on salaries and wages earned in the United States. These taxes are generally not allowable contract costs because the taxes are a liability of the employee, not the contractor. However, a portion of these costs may be allowable under FAR 31.205-6(e)(1), "Domestic and foreign differential pay".

FAR 31.205-6(e)(1) permits contractors to consider the difference between the employees' total income tax payment and the amount that would have been paid had the employee remained on a domestic assignment, as part of foreign differential pay. An assessment of the allowability of costs under this cost principle should be made on a case-by-case basis. The cost principle would apply if the contractor had established policies and procedures regarding foreign differential pay in place at the time the employee earned the moneys to which the taxes apply.

Social Insurance Contributions

Social insurance contributions contain two elements, the employee's share and the contractor's share. The employee's share of the social insurance contributions is generally not allowable because the taxes are a liability of the employee, not the contractor. However, the contractor's share of the social insurance contributions are similar to the types of taxes covered by FAR 31.205-41(a)(1), and thus are generally allowable.

Contract Clauses

Specific contract clauses should be reviewed before making any decision on contractor claims for reimbursement of back taxes. The guidance that follows addresses two of the more prevalent contract clauses affecting this issue.

For open cost-reimbursable type contracts, the allowable costs are reimbursable under FAR 52.216-7, Allowable Cost and Payment, subject to any special contract provisions such as cost/rate ceilings.

For closed cost-reimbursable type contracts, the allowable costs may also be reimbursable under FAR 52.216-7. Paragraph (h)(2)(ii) of this provision requires execution of a release discharging the Government from claims arising from the closed

contract. However, paragraph (h)(2)(ii)(B) excludes from this release any claims based upon liabilities of the contractor to third parties arising out of the performance of the contract that are not known to the contractor as of the date of execution of the release. Thus, the German back taxes may be excluded from this release, depending on whether the contractor had knowledge of the potential back tax liability as of the date of execution of the release.

For fixed-price contracts, the contract price would not be increased under FAR 52.229-6, Taxes - Foreign Fixed-Price Contracts. Paragraph (d) of this clause states:

". . . The contract price shall be increased by the amount of any **after-imposed tax** or of any tax or duty specifically excluded from the contract price by a provision of this contract that the Contractor is required to pay or bear, including any interest or penalty . . ." (emphasis added).

FAR 52.229-6 defines an after-imposed tax as:

". . . any new or increased tax or duty, or tax that was exempted or excluded on the contract date but whose exemption was later revoked or reduced during the contract period, **other than excepted tax**, on the transactions or property covered by this contract that the Contractor is required to pay or bear as the result of legislative, judicial, or administrative action taking effect after the contract date." (emphasis added).

FAR 52.229-6 defines an excepted tax as:

". . . **social security** or other employment taxes, **net income** and franchise taxes, excess profits taxes, capital stock taxes, transportation taxes, unemployment compensation taxes, and property taxes. Excepted tax does not include gross income taxes levied on or measured by sales or receipts from sales, property taxes assessed on completed supplies covered by this contract, or any tax assessed on the Contractor's possession of, interest in, or use of property, title to which is in the U.S. Government." (emphasis added).

The back taxes being assessed meet the definition of excepted taxes. They represent social security and net income taxes (i.e., social insurance contributions and employee income taxes), and are not levied on or measured by sales or receipts from sales. Thus, they are not covered by FAR 52.229-6.



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DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT,
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(CONTRACTING), SAF/AQC
ASSISTANT DEPUTY ASSISTANT SECRETARY OF THE ARMY
(PROCUREMENT)/DIRECTOR FOR CONTRACTING
SENIOR PROCUREMENT EXECUTIVE, DEFENSE
LOGISTICS AGENCY

SUBJECT: Progress Payment Distribution

Contracting officers responsible for administering progress payments shall provide progress payment distribution instructions to the contract paying office for certain new contracts awarded after August 31, 1998. This requirement applies to any fixed-price contract funded with multiple appropriations that is other than a firm fixed price contract. Contracts that are not firm fixed price, e.g., fixed-price incentive contracts, typically require adjustments to obligated funds during contract performance. Most of our contracts with progress payments are firm fixed price and do not need distribution instructions, since they do not entail this kind of adjustment.

Distribution instructions shall include sufficient information to enable the paying office to distribute progress payments from each appropriation funding the contract, in proportions that reasonably reflect the performance of the work on the contract. Instructions shall be updated as necessary. FPI contracts typically include a requirement for quarterly submittal of a contract funds status report (CFSR). The CFSR indicates funds usage by appropriation and should be used in preparing progress payment distribution instructions. Absent a CFSR, the contracting officer should use any other information available to arrive at a best estimate of how appropriations are being used to perform the contract, but it should not be necessary to require contractors to provide any additional information to support this requirement. For research and development funded contracts, contracting officers may assume contractor work will be performed using the earliest fiscal year's funding first, unless there is information available to the contrary.

The foregoing direction requires contracting officers to develop distribution instructions for each appropriation on the contract. However, paying offices maintain contract payment



records using the accounting classification reference numbers (ACRNs) that identify each long line of accounting data cited by the contract. A single appropriation may be included in more than one line of accounting data, and thus be identified by more than one ACRN. Therefore, when providing distribution instructions to the paying office, the contracting officer shall further distribute payment amounts by ACRN. This ACRN-level distribution will ordinarily be on a pro rata basis across the amount to be distributed from each appropriation, unless the contracting officer has information indicating otherwise.

My staff point of contact for this policy is Mr. Richard Brown, (703)695-7197 (e-mail: brownrg@acq.osd.mil).



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