

M e m o r a n d u m**565.0038**

To: Mr. Jack E. Warner
Out-of-State District Principal Auditor

Date: December 30, 1991

From: David H. Levine
Senior Tax Counsel

Subject: [B] --, --.

This is in response to your memorandum dated September 12, 1991 regarding passage of title from a construction contractor to the United States under United States construction contracts. [A], taxpayer's attorney, has asserted that certain provisions are required to be included in United States construction contracts.

You state that in two of the three contracts involved in your audit of [B], FAR 52.245-2 is not specifically incorporated by reference into the contract but rather is included in an index of clauses provided to you by [A]. When the auditor inquired whether all clauses included in the index were part of the contract, [A] provided a letter together with part of a memorandum written by his partner, [C]. You ask whether [A's] assertions in the letter are correct. If so, you ask whether you should conclude that all U.S. government fixed-price construction contracts contain FAR 52.245-2 along with the other clauses contained in the index whether or not specifically incorporated by written reference.

Initially, I note that there is a distinction between fixed-price contracts and other contracts. As explained in Federal Acquisition Regulation (FAR) 36.207(a), firm fixed-price contracts are generally required to be used to acquire construction. However, under some circumstances, cost-plus-fixed-fee, price incentive, or other types of contracts with cost variation or cost adjustment features may be used. (see FAR 36.208.) For purposes of this opinion, I assume that [A's] argument is limited to contracts which are fixed-price construction contracts with the United States.

Subdivision (b)(1) of FAR 45.106 requires the insertion of FAR 52.245-2 in solicitations and contracts when a fixed-price contract is contemplated, except as noted in subdivisions (d) and (e) (subdivision (d) permits use of FAR 52.245-4 when the acquisition cost of government furnished property will be \$50,000 or less and subdivision (e) provides that a government property clause is not necessary for a contract for repair when the cost of property furnished does not exceed \$10,000). In addition to FAR 52.245-2, FAR 52.245-3 is also

required when the government is required to furnish government property F.O.B. railroad cars at specified destinations or F.O.B. truck at the project site. The contract schedule must specify the point of delivery and may include other terms for installation or testing by the government or another contractor. (FAR 45.160(c).)

We do not necessarily agree with [C's] memorandum. He states that DFAR (Department of Defense supplements to the standard FAR) 232.111 requires insertion of DFAR 52.232-7005 [actually 252.232-7005] instead of FAR 52.232-5. Actually, DFAR 232.111 requires insertion of that clause only with respect to fiscal year 1987 appropriations. FAR 52.232-5 is required for all other solicitations and contracts for fixed-price construction contracts. Nevertheless, these provisions are not determinative of the question of when title to property passes to the government. As relevant here, these provisions provide that all material and work covered by progress payments shall, at the time of payment, become the sole property of the government. (DFAR 252.232-7005(d), FAR 52.232-5(f).) The reason these are not determinative (if they were, it would not necessarily help [A] since payment could be well after delivery) is that subdivision (c)(4) of FAR 52.245-2 specifies that title of property passes to the government upon several occurrences, including reimbursement for costs, whichever comes first. Thus, we need look only to that provision to determine passage of title.

The discussion above is an example of the complicated morass of government regulations pertaining to contracts. We agree that if a provision is required by law to be included in a United States construction contract, that provision must be regarded as part of that contract regardless of whether it is incorporated by written reference. Nevertheless, we must also remember that looking at a government regulation that requires insertion of a particular provision does not necessarily mean that such regulation is the final word. That is, there may be some more specific provision, such as DFAR 232.111, that requires replacement of the otherwise required provision with a different provision. This can be seen by viewing the matrix issued as FAR 52.301. Under fixed-price construction contract, FAR 52.232-5 is shown as required. Of course, as discussed above, it is replaced for fiscal year 1987 when the contract is under Department of Defense FAR.

In answer to your specific question, we agree that FAR 52.245-2 is part of fixed-price construction contracts provided: 1) the acquisition cost of property is \$50,000 or more; and 2) there are no more specific regulations superseding the one requiring insertion of FAR 52.245-2. In answer to your question as to whether you should conclude that all fixed-price construction contracts include the other clauses contained in the index, no you should not. For example, FAR 52.245-2 is included in the index you were provided. That provision is optional (as shown on part of the matrix [A] did not provide you). That is, if the cost of government furnished property is less than \$50,000, FAR 52.245-4 may be used, but it does not have to be. Rather, FAR 52.245-2 apparently can be used even if the cost of the property is under \$50,000.

The next question, assuming that FAR 52-245-2 is included in a particular contract is, what does that provision mean. The relevant subdivision, (c)(4), states,

“(4) If this contract contains a provision directing the contractor to purchase material for which the Government will reimburse the Contractor as a direct item of cost under this contract - -

“(i) Title to material purchased from a vendor shall pass to and vest in the Government upon the vendor’s delivery of such material; and

“(ii) Title to all other material shall pass to and vest in the Government upon - -

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

“(B) Commencement of processing of the material or its use in contract performance; or

“(C) Reimbursement of the cost of the material by the Government, whichever occurs first.”

Under this provision, if the vendor’s delivery occurs outside California, then title passes to the United States outside California, and under our previous interpretations the contractor would be regarded as selling that property to the United States rather than consuming it. You ask whether we should apply Regulation 1628 to determine the meaning of “delivery.” You believe that “upon the vendor’s delivery” should be interpreted according to the intent of the parties to the contract and that the most likely intended meaning of “delivery” would be the transfer of physical possession.

The provisions of subdivision (d) of Regulation 1628 are based upon section 2401 of the Uniform Commercial Code. As relevant here, that provision provides that the sale occurs at the time and place at which the retailer completes its performance with reference to the physical delivery of the the property. This provision uses the term “delivery” as part of its determination of when the sale occurs. The Uniform Commercial Code does not specifically define “delivery” with reference to property (the only definition of delivery in the Code pertains to delivery of documents of title, etc.). We believe that “completion of performance with reference to physical delivery” doe not necessarily occur at the same time that “delivery” occurs. The first phrase, from U.C.C. section 2401(2), looks to the activity of the seller. Thus, when the seller delivers the property to, for example, UPS, that seller has completed its performance with respect to physical delivery. On the other hand, in our opinion the bare term “delivery” refers to receipt by the person to whom the property is shipped.

We agree that the term "delivery" in FAR 52.245-2(c)(4)(i) means what the parties intend it to mean. As far as we can tell, there is no definition of that term in FAR nor, as mentioned above, is there a specific definition of the term under state contract law in the Uniform Commercial Code. We conclude that the term should be defined according to its usual meaning. We believe that the usual meaning of this term in the context of the vendor's delivery is that delivery occurs upon receipt by the contractor of physical possession of the delivered product. We therefore agree with your conclusion that the contractor owes use tax in accordance with subdivision (b)(1)(A) of Regulation 1521 if that contractor does not first obtain physical possession of the property outside California since, under such circumstances, title would not be transferred to the United States outside California.

If you have further questions, feel free to write again.

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cc: Mr. Glenn A. Bystrom
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