

565.1301

## Memorandum

To: Charlotte Paliani  
Program Planning Manager (MIC:92)

Date: April 2, 2003

From: Randy Ferris  
Senior Tax Counsel (MIC 82)

Subject: **FAR 52.232-32**

Your memorandum to Assistant Chief Counsel Janice Thurston, dated February 7, 2003, has been assigned to me for reply. In your memorandum, you request a legal opinion regarding whether Federal Acquisition Regulation (FAR) 52.232-32 (i.e., the “performance-based payments clause”) is acceptable, in lieu of FAR 52.232-16 (i.e., the “progress payments clause”), to pass title to the federal government prior to use, thereby avoiding the application of tax, assuming all the requisite conditions are met, with respect to transactions under United States (U.S.) government supply contracts. (See Cal. Code Regs., tit. 18, § 1618 [defining “United States Government supply contracts” and the application of tax to transactions pursuant to such contracts]; see also *Aerospace Corp. v. State Bd. of Equalization* (1990) 218 Cal.App.3d 1300.)

Your request arises from a January 30, 2003, memorandum authored by the Principal Auditor of the San Diego District, Kenneth D. Fox, who writes:

“It appears that within the aerospace industry, regarding tooling charges, the Government community has shifted from the Progress Payments Clause FAR 52.232-16 to that of a Performance[-]Based Payment (PBP) Clause FAR 52.232-32. The taxpayer [i.e., REDACTED TEXT]) has asked our legal opinion on whether or not the FAR clause 52.232-32 is acceptable in lieu of the Progress Payment Clause 52.232-16.

“We are requesting your guidance in this area. Based on discussions with the taxpayer there has been a strong industry shift to this type of financing transfer. Thanks for your assistance.”

For purposes of responding to this request for guidance, I assume that the “tooling” Mr. Fox refers to does not include “special tooling” subject to the provisions of FAR 52.245-17 or regulations that succeed FAR 52.245-17, if any. (See Cal. Code Regs., tit. 18, § 1618, subd. (a)(2).)

## **DISCUSSION**

As you know, gross receipts from sales to the U.S. government are exempt from sales tax. (Rev. & Tax. Code, § 6381; Cal. Code Regs., tit. 18, § 1614.) With respect to U.S. government supply contracts, when the subject contractor uses direct consumable supplies and overhead materials<sup>1</sup> before passing title to such property to the U.S. government, assuming the contractor acquired the property on an ex-tax basis by issuing a resale certificate or from an out-of-state vendor, the contractor owes use tax measured by the sales price the contractor paid for the property. (See Cal. Code Regs., tit. 18, §§ 1618, 1668.)

In relevant part, FAR 52.232-16 provides as follows:

(d) Title. (1) Title to the property described in this paragraph (d) shall vest in the [U.S.] 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.

As you further know, the express incorporation of FAR 52.232-16's title clause into a U.S. government supply contract, and into any related subcontracts pendant thereto, operates to transfer title to direct consumable supplies and overhead materials from the subject contractor to the federal government. (See, e.g., Business Taxes Law Guide, vol. 2, Annots. 565.1140, 565.1300.) If the subject contractor has made no prior use of the relevant direct consumable supplies and overhead materials, on and after the date of the relevant contract, FAR 52.232-16's title clause operates to avoid the application of tax to transactions involving the transfer of such property to the U.S. government. However, the express incorporation of FAR 52.232-16's title clause cannot effect the avoidance of tax with respect to transactions involving direct consumable supplies and overhead materials that the subject contractor used prior to the date of the relevant contract. In other words, entering into such a contract cannot retroactively cause already taxable transactions to become nontaxable.

In contrast, FAR 52.232-32 provides, in relevant part, as follows:

(f) Title. Title to the property described in this paragraph (f) shall vest in the [U.S.] 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.

Comparing FAR 52.232-32 with FAR 52.232-16, assuming that the date of the first performance-based payment will be some time after the date of the contract, an additional period exists during which the subject contractor, who has purchased direct consumable supplies and overhead materials on an ex-tax basis by issuing a resale certificate or from an out-of-state vendor, would be liable for use tax if the contractor uses such property prior to the vesting of title in the U.S. government. Again, the operation of FAR 52-232-32's title clause does not retroactively change already taxable transactions into nontaxable transactions.

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<sup>1</sup> "Direct consumable supplies" and "overhead materials" are defined in Regulation 1618. (See Cal. Code Regs., tit. 18, § 1618, subd. (a)(2) & (a)(3).)

In sum, while FAR 52.232-32 and FAR 52.232-16 are similar, they are not interchangeable. In particular, U.S. government supply contractors will, in all likelihood, be more susceptible to use tax liability under FAR 52.232-32 because of the lag time between the date of the subject contract and the date of the first performance-based payment under that contract. Once the first performance-based payment occurs, however, the title clauses of FAR 52.232-32 and FAR 52.232-16 have the same effect with respect to the avoidance of the application of tax.

I trust that the foregoing adequately addresses your request for guidance. To the extent any questions or concerns remain, please do not hesitate to contact me.

RMF:rmf

cc: Mr. Kenneth D. Fox  
San Diego District Principal Auditor (FH)

REDACTED TEXT