

M e m o r a n d u m

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To: Mr. Glenn Bystrom
Principal Tax Auditor

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From: John L. Waid
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Subject: Operations Memo 975

As a result of our recent conference on the above matter, I have undertaken extensive research into the pertinent provisions of the Federal Acquisition Regulations (FAR; 48 CFR) and their derivation from the Armed Services Procurement Regulations (ASPR) and, where applicable, the Federal Procurement Regulations (FPR: former 41 CFR). As you are aware, prior to the promulgation of the FAR, there were no central procurement regulations. Each agency had their own. First published in Federal Register (FR) 42102-42797 (9/19/83), and effective April 1, 1984, the FAR attempted to provide one set of procurement regulations to apply to each government agency. The supplements issued by each agency were supposed to deal with agency-peculiar procurement situations and needs, provide necessary agency implementation procedures, and displace the existing agency procurement regulations. (ABA, Public Contract Law Section, The FAR System: Its Critical Formative Years, 1984-1986 (1988) ("The FAR System"), "First Quarterly Report (July 31, 1984)", A-1.14.) The Office of Federal Procurement Policy (OFPP), the office responsible for creating the FAR, regarded the FAR not as a new set of regulations or a new layer of regulations but as a consolidation and simplification of existing agency regulations. (Ibid. A01, 15-1. 16.)

That was the theory at any rate. As reflected in all of the quarterly reports reprinted in The FAR System, the enabling legislation did not give the OFPP the authority to drive through agency territoriality and red tape. As a result, the much-ballyhooed uniformity remains more a statement of policy than a reality. The reports all bemoan the fact that agencies were issuing what amounted to separate regulations and putting in internal procedures that were must better left to internal memoranda. For example, the Department of Defense basically re-issued as its "implementing regulations" the ASPR with a minimum of revising to match the FAR format. (Ibid., H-1.1.) As a result, the agency supplements still need to be consulted to see if there is any deviation from the FAR regarding title passage.

On one thing they do agree. All contracts in existence on April 1, 1984, remain governed by the acquisition regulations as they existed on the date of execution of the contracts.

What follows is a discussion of the title-passage clauses affected the major types of property which occupy our attention. Title to the property actually furnished by the Government remains in the Government. This principle is carried thorough all of the regulations. (See, e.g., ASPR 7-

104.24(c); FAR 52.245-2(c)(1).) Our problem concerns property which is acquired or manufactured by the government Contractor for use in accomplishing its contract(s) with the Government, title to which is deemed to pass to the government prior to use by the contractor under the Aerospace case. (218 Cal.App.3d 1300). Therefore, unless there is a variation in this general rule, we will discuss only property which comes under the Aerospace rule. All further references to title passing will be understood to mean “passing title to the United States prior to use by the contractor.”

A. Government Property In General

1. Fixed-price Contracts.

(a.) Overhead Materials (Indirect Cost Property).

(1a.) ASPR & FPR. Neither set of regulations provided for accelerated title passage to overhead materials in their government-property clauses (ASPR 7-103.6(a); 7-104.24(c).) Aerospace made it clear that clauses passing title to items of direct cost do not apply to overhead materials. (218 Cal.App.3d at 1311.)

(2a.) Progress Payments Clauses. Aerospace held that Progress Payment clauses (the regulation’s term) which provided for the passing of title to all property upon allocation of the property to the contract were sufficient to pass title prior to use. (218 Cal.App.3d at 1311-1312.) ASPR 7-104.35(d) and FPR 1-30.510.1(d) both provided that title to all parts, materials, inventories, and work in progress in existence at the time of execution and work in progress previously manufactured or acquired by the contractor and properly chargeable or allocable to the contract under generally accepted accounting principles vested in the government on execution of the contract and such property thereafter manufactured or acquired by the contractor vested in the government upon acquisition, production or allocation. This was the clause before the court in Aerospace. (218 Cal.App.3d at 1304.)

(b.) FAR.

(1.) The Progress Payments Clause in the FAR is substantially identical to the previous clauses and covers the same kind of property. Although it continues the previous rule regarding title to previously-acquired property vesting in the government upon execution of the contract, it limits the passing of title to such property thereafter manufactured or acquired by the contractor vests to allocation to the contract. (48 CFR § 52.232-16(d)(1); Atch. B.)

(2.) The FAR also continues the previous rule that title to property which vests in the government under the clause, but of which the government did not actually get possession, re-vested in the contractor at the end of the contract. (See 48 CFR § 52.232-16(d)(6); Atch. B.)

(3.) Conclusion. For title to overhead materials to pass to the government prior to use by the contractor, the contract must contain the proper Progress Payments clause. The rule is the same for contracts executed under the ASPR and FPR as well as those executed under the FAR: title vests on allocation of the property to the contract.

2. Direct Cost Items.

(a.) ASPR and FPR did not make specific provision for such items, so title to them passes only if there is a progress payments clause.

(b.) FAR 52.245-2(c) (the famous – notorious? – “Government Property” clause) only covers items for which the government will reimburse the contractor as an item of direct cost under the contract. Thus, title to such items passes under to FAR when either the Government Property or the Progress Payments clauses are present in the contract. (See, Atch. A).

(c.) Conclusion. For contracts executed under either the ASPR or FPR, title to direct-cost items passes only if the Progress Payments clause is present. For contracts executed after April 1, 1984, title to such materials passes if either that or the Government Property clause is present.

3. Cost-Reimbursement Contract. Title to contractor-acquired property passes under identical conditions in all three sets of regulations. ASPR 7-402.25(c) and FPR 1-703.21(c) read just as FAR 52.245-5(c) does today. (See, Atch. E.) All three clauses cover all contractor-acquired property, even items, such as special tooling, which would be covered by separate clauses if the contract were for a fixed price.

B. Special Tooling

1. Fixed-Price Contracts.

(a.) FPR and ASPR. The FPR was silent on the issue of special tooling, but the ASPR as it read in 1983 declared that it was governmental policy that the contractor retain title to all special tooling except under the circumstances set forth in the contract. (§ 13-205.1(a).) ASPR 7-104.25(f)(i) provided that the government could require the contractor to transfer title to it of all special tooling acquired or manufactured for the contract to the extent that title was not transferred under any other passage of the contract, or accept the contractor’s offer under sub-section (e) to purchase any governmental residual interest in the special tooling or otherwise dispose of it as required.

(2a.) The Lockheed case recognized that title to special tooling passes to the government under the Progress Payments clause. (81 Cal.App.3d at 263; ASPR 7-104.35(d).) Thus, under pre-FAR contracts, accelerated passage of title to special tooling occurs only when there is a Progress Payments clause.

(b.) FAR (4/1/83 – 12/28/89).

(1b.) The new Special Tooling clause continued the policy of the ASPR. (See, Atch. C.) The new Government Property clause provided that special tooling other than that subject to the special tooling clause (52.245-17(a)) passed to the government when its use in performing the contract commenced or when the government paid for it, whichever was earlier. (52.245-2(c)(3); Atch. A.)

(2b.) Under the new Progress Payments clause, title to special tooling to which the government was entitled to take title under any clause of the contract passed on execution of the contract or when the property was or should have been allocable to the contract. (52.232-16(d)(1) & (2)(ii).) Under the rationale of the Lockheed court the existence of the Progress Payments clause in the contract would accelerate title to the special tooling which it covered.

(c.) FAR (12/28/89 – Present). Apparently the system set up by the FAR in 1983 caused some confusion as to when the government actually took title to special tooling. According to the Supplementary Information to the 1989 revisions, the Special Tooling clause was revised to “clarify that the clause is used in fixed-price contracts when the Government will furnish special tooling to the contractor, or the Government intends to maintain rights to the special tooling until such time that the Government decides it wants full title to the special tooling or has no further interest in the special tooling.” (FR 48981 (Nov. 28, 1989).) Thus the Government Property clause was amended to reflect that special tooling accountable to the contract was subject to the Special Tooling clause and not to the Government Property clause. (§ 552.245-2(c)(2).) The Special Tooling clause was modified to read as it does today (Attachment C). The Government now retains only an option to take title to all special tooling covered by the contract.

(d.) Conclusion. In both the ASPR and FAR as it read until 1989, if only the Special Tooling clause were present in the contract, then the contractor retained title to the special tooling which it acquired or manufactured for the contract until requested to transfer title by the government, usually at the end of the contract. If only the Government Property clause were present, then title to the kinds of special tooling which were not subject to a Special Tooling clause would pass when its use on the contract commenced or when the Government paid for it, whichever came earlier. If the Progress Payments clause were also present, that would indicate that title to all special tooling passed when it was allocated or became properly allocable to the contract. Such was the conclusion of the Lockheed court. However, given the express declaration in the Government Property clause as modified in 1989, we conclude that the Progress Payments clause was not intended to accelerate title to special tooling under the FAR. The government must now to something affirmative in order to obtain title.

2. Cost-Reimbursement Contracts. Title passage is the same under the ASPR, FPR, and FAR. ASPR § 7-203.21(c), FPR § 1=703.21(c) and FAR § 52.245-5 provide for identical conditions for passage of title. (See Attachment E.)

C. Special Test Equipment

1. FPR & ASPR. The FPR is silent on the subject, and ASPR 7-104.26 does not provide for the government to take title to such equipment, even that fabricated or acquired at government expense. Note that the Lockheed case (81 Cal.App.3d 257), found that Special Test Equipment was sub-set of Special Tooling so that the same rules which applied to tooling applied to test equipment. However, the ASPR was revised in 1973, after the sales in Lockheed took place, to state that special tooling did not include special test equipment. (7-104.25(a)(1)(ii).) After 1973, then, it appears that Special Test Equipment was not subject to accelerated title provisions of the Progress Payments was not subject to the accelerated title provisions of the Progress Payments clause as that clause only applied to such equipment to which the government had the right to take title under the contract. (See, 7-104.35(d).)

2. FAR.

(a.) The Special Test Equipment clause authorizes the Contractor to acquire or manufacture special test equipment for the government at government expense under certain circumstances. (Atch. D). The Government Property and Progress Payment clauses accelerate title to each item of special test equipment acquired by the Contractor for the Government under the conditions set forth in the statute. (Appendices A & B respectively).

(b.) Revisions to the FAR have not affected passage of title to special test equipment.

D. Government Property in Research and Development Contracts with Non-Profit Educational or Research Institutions.

1. ASPR.

(a.) Fixed Price Contracts. Unless the contract requires an earlier passage of title, title to supplies covered by the contract passes to the Government upon formal acceptance, regardless of when the Government gets actual physical possession. (7-304.24.)

(b.) Cost-Reimbursement Contracts. 7-402.25(c)(2) provides that title to all equipment purchased with funds available for research and having an acquisition cost of less than \$1,000 shall vest in the contractor on acquisition or as soon as possible thereafter providing the contractor gets the approval of the contracting officer prior to acquisition. Title to equipment having an acquisition price of over \$1,000 passes as set forth otherwise in the contract. (7-402.25(c)(3).) Title to direct cost property title to which the contract provides is to pass to the Government vests in the same manner as now provided in FAR 52.245-2(c)(4)(i), Alt. II (See Atch. A). Title to all other property the costs of which the Contractor gets reimbursed under the contract and title to which is to vest in the Government passes in the same manner as now provided in FAR 52.245-2(c)(4)(ii), Alt. II. (7-104.25(c)(8).) (See Atch. A).

(1b.) Special Test Equipment. 7-403-33 provided that the Contractor retained title to special test equipment.

2. FPR. Title passage for both Fixed-Price and Cost-Reimbursement contracts passed in the same manner as under ASPR 7-402.25(c). (1-7.402.25, respectively.)

3. FAR.

(a.) Fixed-Price Contracts. The rules for fixed-price contracts under the FAR are the same as they were for cost-reimbursement contracts under ASPR and for fixed-price contracts under FPR. (See, 52.245-2(c), Alt. II (Atch. A).) The clause is substantially unchanged since it became effective in 1984 except that, effective July 1, 1985, the threshold amount was raised to \$5,000, where it remains today. (FR 26904 (June 28, 1985).)

(b.) Cost-Reimbursement Contracts. The rule is the same as for Fixed-Price Contracts. (52.245-5(c), Alt. I; See, Attach. A.)

4. Special Tooling and Special Test Equipment are subject also to the alternative clauses set forth above, except that, after 1989, special tooling is controlled by the Special Tooling clause in the case of fixed-price research and development contracts. (52.245-(c)(3), Alt. II (Attach. A).)

Appendix

<u>Contract</u>	<u>Property</u>	<u>FAR Section</u>
Fixed-Price	Indirect Cost	Progress Payments (52.232-16(d)(2)(i))
	Direct Cost	Government Property (52.245-2(4)); or Progress Payments (52.232-16(d)(2)(i))
	Special Tooling	None. Special Tooling not subject to accelerated passage of title.
	Special Test Equipment	Special Test Equipment (52.245-18(b)); and Government Property (52.245-2(3)); and/or Progress Payments (52.232-16(d)(2)(ii))
Cost-Reimbursement	Direct Cost	Government Property (52.245-5(c)(2))
	Indirect Cost (Overhead)	Government Property (52.245-2(c)(3))
Non-Profit Research	Property purchased with funds available for research and having an acquisition cost of over \$5,000*	Government Property (52.242-2(c)(4), Alt. II)
	Special Tooling	<u>Pre-1989</u> Government Property (52.245-2(c)(3), ALT. II) <u>Post-1989</u> Special tooling not subject to accelerated title passage.
	Special Test Equipment	Government Property (52.245-2(c)(3), Alt. II)

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