



STATE BOARD OF EQUALIZATION

Board of Equalization
Legal Division-MIC:82
Telephone: 324-3828

Date: July 29, 1996

To: Mr. William R. Pitts
Supervising Tax Auditor,

From: John L. Waid
Senior Tax Counsel

Subject: United States Government Service Contracts -- Title Clauses

At the request of Mr. Michael P. Kitchen of the Audit Review and Refund Section, I am responding to your memorandum to him dated April 24, 1996. You ask if --- may buy overhead materials ex tax for resale to the United States under the ruling in Aerospace Corporation v. State Board of Equalization (1990) 218 Cal.App.3d 1300. Attached to your memorandum are excerpts from its contract with the United States that contain the title clauses and describe certain aspects of the work.

According to the contract documents, --- is providing its services directly to the --- at --- AFB. Although it is not clear from the documents, the conversations I have had with Mr. Kitchen on this indicate that the taxpayer is providing "qualified production services" under Regulation 1529. We will assume for the purposes of this discussion that it is. As a result, it would normally be the consumer of any tangible personal property it purchases for use in providing such services. (Reg. 1529(a) (1).) As I understand it, the issue is whether or not Aerospace overrides the regulation and permits the taxpayer to buy the property for resale. We find under the facts of this case, however, that we do not need to reach this issue.

Section I of the Contract is the part which incorporates by reference FAR contract clauses. FAR 52.245-2 is specifically incorporated, but 52.232-16 is not. We note that DFARS 252.227-7013, which provides that the contractor remains the consumer of any software it purchases that contains a restriction on transfer, is also incorporated.

OPINION

The Aerospace case construed two title clauses that are substantially similar to those contained in FAR 52.232-16 and FAR 52.245-2. The first, which provides for progress payments, was the clause which the court held passed title to overhead materials to the government prior to use by the contractor, thus permitting the contractor to buy such materials free of tax for resale. (Ibid. at 1311.) FAR 52.245-2(c) provides for accelerated title passage to items of direct cost only.

Aerospace held that the resolution of this issue is determined by the clauses of the contract. (Ibid. at 1313.) As FAR 52.232-16 is not incorporated into this contract, no clause in this contract provides for accelerated passage of title to overhead materials to the United States prior to its use by ---. Therefore TSD is the consumer of the items that it purchases to perform qualified production services and may not purchase such property for resale to the United States.

JLW: sr

cc: Mr. Michael Kitchen (MIC:39)