

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of -- )  
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Westech International, Inc. ) ASBCA No. 57296  
 )  
Under Contract No. W9115U-05-C-0001 )

APPEARANCE FOR THE APPELLANT: Carolyn Callaway, Esq.  
Albuquerque, NM

APPEARANCES FOR THE GOVERNMENT: Raymond M. Saunders, Esq.  
Army Chief Trial Attorney  
CPT Matthew E. Dyson, JA  
Trial Attorney

OPINION BY ADMINISTRATIVE JUDGE JAMES

On 27 July 2010 Westech International, Inc. (Westech) appealed to the Board from the contracting officer's (CO) failure to issue a decision on its 25 March 2010 claim for reimbursement of \$69,179.83 in Arizona transaction privilege taxes, and \$7,938.43 in penalties and interest thereon, that Westech paid for tangible personal property provided in 2008 and 2009 to the Army under the captioned cost-plus-award-fee contract. Thereafter, the CO issued a decision denying Westech's claim. The Board has jurisdiction of the appeal under the Contract Disputes Act of 1978 (CDA), 41 U.S.C. §§ 7103(f)(5), 7105(e)(1)(A). The parties submitted the appeal on the record pursuant to Board Rule 11. The record includes the government's and Westech's Rule 4 documents, the parties' briefs, reply briefs and attachments thereto. We decide entitlement only (Bd. Order dtd. 1 Oct. 2010).

FINDINGS OF FACT

1. On 31 March 2005 the U.S. Army Test and Evaluation Command (ATEC) awarded Contract No. W9115U-05-C-0001 (the contract) to Westech for non-personal, mission support services for the Intelligence Electronic Warfare Test Directorate (IEWTD or AMSCA) to be performed primarily at Ft. Huachuca, AZ (R4, tab 1 at 1, 24).
2. The contract had a base year from 1 April 2005 through 31 March 2006, and four option years whose performance ended on 31 March 2010. All four options were exercised. (R4, tab 1 at 4-23; compl. and answer ¶ 3)
3. The contract was a cost-plus-award-fee type contract to provide, by the prime contractor or by subcontract, *inter alia*, all materials, equipment, tools and items not

provided as government furnished property in accordance with a performance based work statement (R4, tab 1 at 4, 78-80).

4. The contract included the FAR 52.216-7, ALLOWABLE COST AND PAYMENT (DEC 2002) clause, whose ¶ (b) provided for reimbursement of the allowable costs of supplies and services purchased directly for the contract and of allocable and allowable indirect costs in accordance with FAR subpart 31.2 in effect on the date of the contract (R4, tab 1 at 84-87). FAR 31.205-41 as in effect 31 March 2005 provided:

(a) The following types of costs are allowable:

(1) Federal, State, and local taxes (see Part 29), except as otherwise provided in paragraph (b) of this section that are required to be and are paid or accrued in accordance with generally accepted accounting principles. Fines and penalties are not considered taxes.

(2) Taxes otherwise allowable under subparagraph (a)(1) of this section, but upon which a claim of illegality or erroneous assessment exists; provided the contractor, before paying such taxes—

(i) Promptly requests instructions from the contracting officer concerning such taxes; and

(ii) Takes all action directed by the contracting officer arising out of subparagraph (2)(i) of this section or an independent decision of the Government as to the existence of a claim of illegality or erroneous assessment, to—

(A) Determine the legality of the assessment; or

(B) Secure a refund of such taxes.

(3)...Interest or penalties incurred by the contractor for non-payment of any tax at the direction of the contracting officer or by reason of the failure of the contracting officer to ensure timely direction after a prompt request.

....

(b) The following types of costs are not allowable:

....

(3) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Government, except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Government.

5. The State of Arizona imposes a transaction privilege tax (TPT) on certain transactions (Ariz. Rev. Stat. Ann. § 42-5061). The 2 July 2008 e-mails between ATEC and Westech stated that ATEC was researching the applicability of the Arizona TPT to subcontracts under the contract; if applicable, the CO would authorize Westech to pay and bill for such taxes; if determined inapplicable, ATEC would provide Westech with the necessary documentation for the Arizona tax authorities. ATEC stated that payment of the TPT would not be approved until the issue of the applicability of the tax was resolved. (R4, tab 18 at 1-5, tab 21 at 1)

6. An agency attorney advised ATEC on 19 February 2009 that under a cost plus contract the Arizona TPT was a legitimate expense and “[n]o exemptions appear to be applicable to your contractor for your support contract, but your contractor should continue to seek ways to avoid the tax if possible” (R4, tab 18 at 6). CO Woods’ 23 February 2009 e-mail to Westech stated: “Based on the legal finding, it appears there are no tax exemptions applicable to your subcontracting actions. You are authorized to pay the tax. However, Westech should continue to seek ways to avoid the tax, if...possible.” (R4, tab 18 at 8)

7. CO Woods’ 17 July 2009 letter to Westech regarding subcontracted items stated that the TPT “is a tax on the seller, not the purchaser,” “under a cost type contract, anything bought by WESTECH immediately becomes Government property,” the TPT “is an invalid application of the tax to the Government” and the TPT tax “is considered unallowable and is disapproved” (R4, tab 3).

8. The 27 August 2009 letter of Westech’s president and CEO, Ms. Betty P. Chao, to CO Woods asked her to reverse her 17 July 2009 letter disallowing TPT costs. Westech attached a letter of the same date from the CPA firm Moss Adams LLP stating that “the sales made by Westech to the Army are ‘retail sales’ and Westech is entitled to exclude 50% of the gross receipts from taxation. Additionally, the tax is an allowable cost under the [FAR], and, therefore, reimbursable.” (R4, tabs 6, 7)

9. On 18 December 2009, Westech submitted a voucher for TPT for 2008. A government 18 December 2009 e-mail rejected the voucher, stating: “Reason for

rejection: Payment of Arizona Privilege Tax for CY08 is prohibited by the Contracting Officer until further notice.” (R4, tab 19 at 1)

10. On 27 January 2010, Westech submitted a voucher for TPT for 2009. A 27 January 2010 government e-mail rejected the voucher, stating: “Reason for rejection: Arizona Privilege Tax not authorized for payment by the AMSCA Contracting Officer. Payment is denied until further direction received. J. Neal COR” (R4, tab 20 at 1).

11. On 8 March 2010 Westech filed amended Arizona TPT returns for sales of tangible personal property under the contract, taking a 50% deduction on all items sold directly to the U.S. Government and stating additional taxes due in 2008 of \$28,081.28 and in 2009 of \$41,098.56 (R4, tabs 13, 14). On 10 March 2010 Westech issued to the Arizona Department of Revenue Check No. 5124 in the amount of \$28,081.28 and Check No. 5125 in the amount of \$41,098.55 (R4, tab 15).

12. Attorney Carolyn Calloway’s 25 March 2010 letter to CO Woods, received on about 31 March 2010, submitted a claim under the CDA for \$69,179.83 in TPT taxes Westech paid to Arizona in 2008 and 2009, and penalties and interest thereon, and stated (R4, tab 8):

[The] Contract...is cost reimbursable. FAR 31.205-41 TAXES explicitly provides that state taxes “required to be paid or are paid” are allowable costs. So far as can be determined by WESTECH, payment of the Tax is required and no exemption is applicable to the transactions under the Contract. WESTECH is not an agent of the government for these purchases and your agency has not provided WESTECH with a U.S. Tax Exemption Form. Nevertheless, WESTECH’s invoices for the Tax have been rejected and your letter of July 17, 2009, specifically disapproved reimbursement of the Tax as “unallowable.”

13. On 7 April 2010 the Arizona Department of Revenue sent notices to Westech which did not question its 50% deductions for property sold to the U.S. Government on Westech’s 8 March 2010 amended returns, but assessed \$7,938.43 in interest and penalties thereon (R4, tab 16). On 16 April 2010 Westech issued a check in the amount of \$7,938.43 to the Arizona Department of Revenue (R4, tab 15).

14. On 27 July 2010 Westech filed notice of appeal from the CO’s failure to decide its 25 March 2010 claim. On 17 August 2010 CO Woods denied Westech’s 25 March 2010 claim (R4, tab 9).

## DECISION

### I.

It is the government's burden to establish the unallowability of claimed costs. *BearingPoint, Inc.*, ASBCA Nos. 55354, 55555, 09-2 BCA ¶ 34,289 at 169,398; *see also Fiber Materials, Inc.*, ASBCA No. 53616, 07-1 BCA ¶ 33,563 at 166,252 (government normally has the burden to prove that a cost is unallowable due to a contract provision, statute or regulation, except when a given regulation requires the contractor to establish entitlement to a cost); *Lockheed-Georgia Co., A Division of Lockheed Corp.*, ASBCA No. 27660, 90-3 BCA ¶ 22,957 at 115,276 (establishing the unallowability (by operation of specific contract provision or regulation) of a cost which is reasonable and allocable to the contract is normally the government's burden).

The government argues that (1) tangible personal property used in research and development is exempt from the TPT under Ariz. Rev. Stat. Ann. § 42-5061, Westech used the equipment on which it paid TPT to perform research and development under the contract, so the TPT taxes are not allowable under FAR 31.205-41(b)(3), and (2) interest and penalties paid on delinquent TPT are not considered taxes and hence are not allowable under FAR 31.205-41(a)(1).

Westech argues that it promptly requested the CO's instruction on what to do about the Arizona TPT on various subcontracted equipment, but the CO did not direct Westech to determine the legality of such taxes or direct it to litigate the issue with Arizona, in accordance with FAR 31.205-41(a)(2); and since the CO directed Westech not to pay the TPT, interest and penalties on delinquent TPT are allowable under FAR 31.205-41(a)(3).

### II.

Notwithstanding CO Woods' 17 July 2009 views expressed to Westech with respect to the invalidity of the Arizona TPT (finding 7), the United States Supreme Court upheld the validity of the Arizona TPT as applicable to federal contractors in *Arizona Department of Revenue v. Blaze Construction Co.*, 526 U.S. 32, 36 (1999); *see also GarCom, Inc.*, ASBCA No. 55034, 06-1 BCA ¶ 33,146 at 164,265 (no legal issue as to Arizona's right to impose the TPT).

On 10 March 2010 Westech paid the full amounts of the Arizona TPT taxes due for 2008 and 2009 as shown on its returns filed 8 March 2010 (finding 11). FAR 31.205-41(a)(1) provides that the costs of state taxes are generally allowable, provided they "are required to be and are paid or accrued in accordance with generally accepted accounting principles" (finding 4); *see Information Systems & Networks Corp. v. United States*, 437 F.3d 1173, 1177 (Fed. Cir. 2006) (in *dicta* the court said that when state taxes

were required to be “paid and were paid...by the contracting entity,” they are allowable in accordance with FAR 31.205-41(a), but held the disputed taxes were not allowable because they were not paid by the “contracting entity,” a subchapter S corporation, but by its sole shareholder).

The government argues that tangible personal property used in research and development is exempt from the TPT under Ariz. Rev. Stat. Ann. § 42-5061, and so Westech’s taxes were not allowable pursuant to FAR 31.205-41(b)(3). FAR 31.205-41(a)(2) establishes a procedure for determining whether taxes are due in case of doubt. If the government really believed such an exemption was available (despite its agency attorney’s advice to the contrary (finding 6)), it could have instructed Westech to litigate that issue in Arizona. The CO did not do so (findings 7, 9-10). The government evidently seeks to have the Board independently determine whether the Arizona research and development exemption was available, but that is a matter for the Arizona taxing authorities and courts. We hold that the TPT Westech paid to Arizona for years 2008 and 2009 was an allowable cost pursuant to FAR 31.205-41(a)(1).

### III.

To prevail on the issue of recovery of interest and penalties, Westech must show that it did not pay the Arizona TPT timely “at the direction of the [CO] or by reason of the failure of the [CO] to ensure timely direction after a prompt request.” FAR 31.205-41(a)(2)(ii).

On 2 July 2008 ATEC advised Westech that, after ATEC completed its investigation of the applicability of the Arizona tax, if the tax was determined to be applicable, Westech would be authorized to pay and bill for the taxes, but if not so determined, Westech would be provided the necessary documentation for the state tax authorities; and that Westech was not to pay the TPT until the CO authorized such payment (finding 5). On 23 February 2009 CO Woods authorized Westech to pay the TPT, but she also instructed Westech to continue to seek ways to avoid the tax (finding 6). On 17 July 2009 the CO told Westech that the TPT was “considered unallowable and is disapproved” (finding 7). On 18 December 2009 and on 27 January 2010 the government rejected Westech’s vouchers for reimbursement of the 2008 and 2009 Arizona TPT, respectively, stating that such payments were “prohibited” and “not authorized for payment” by the CO (findings 9, 10).

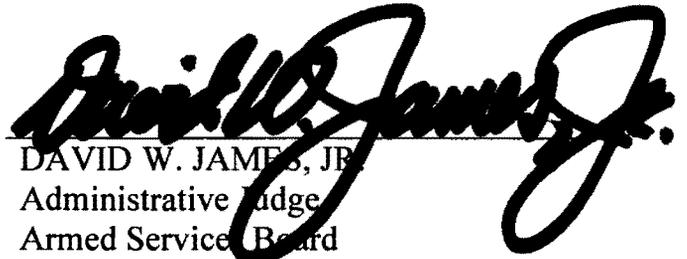
Considering the CO’s foregoing directions to Westech, we hold that Westech did not pay the Arizona TPT until 10 March 2010 at the direction of the CO pursuant to FAR 31.205-41(a)(2)(ii). Therefore, the interest and penalties Westech paid on the delinquent TPT on 16 April 2010 (finding 13) are expressly allowable pursuant to FAR 31.205-41(a)(3). *Cf. Lockheed Corp. v. Widnall*, 113 F.3d 1225, 1228 (Fed. Cir. 1997)

(interest paid on an underpayment of state taxes was allowable and did not represent "interest on borrowings" under DAR 15-205.17, now FAR 31.205-20).

CONCLUSION

The appeal is sustained.

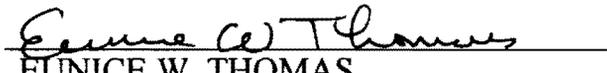
Dated: 9 August 2011

  
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DAVID W. JAMES, JR.  
Administrative Judge  
Armed Services Board  
of Contract Appeals

I concur

  
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MARK N. STEMLER  
Administrative Judge  
Acting Chairman  
Armed Services Board  
of Contract Appeals

I concur

  
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EUNICE W. THOMAS  
Administrative Judge  
Vice Chairman  
Armed Services Board  
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 57296, Appeal of Westech International, Inc., rendered in conformance with the Board's Charter.

Dated:

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CATHERINE A. STANTON  
Recorder, Armed Services  
Board of Contract Appeals