ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Environmental Chemical Corporation	)	ASBCA No. 54141
	)	
Under Contract Nos. DACA45-95-D-0026 *et al.*	)	

APPEARANCES FOR THE APPELLANT: Thomas M. Abbott, Esq.
Laura O. Doyle, Esq.
McKenna Long & Aldridge LLP
Los Angeles, CA

APPEARANCES FOR THE GOVERNMENT: Thomas B. Pender, Esq.
Chief Trial Attorney
Gregory T. Allen, Esq.
Sharon K. Parr. Esq.
Trial Attorneys
Defense Contract Management Agency
Manassas, VA

OPINION BY ADMINISTRATIVE JUDGE DICUS
ON APPELLANT'S MOTION FOR SUMMARY JUDGMENT

Environmental Chemical Corporation (appellant or ECC) has filed a motion for summary judgment contending there are no genuine issues of material fact and seeking judgment as a matter of law (app. mot. at 2). The government has opposed the motion for summary judgment stating that disputed material facts preclude summary judgment and the government has not had the opportunity to conduct adequate discovery (gov't resp. at 2). We deny the motion.

FINDINGS OF FACT FOR PURPOSES OF THE MOTION

1. ECC is a corporation organized under Subchapter S of the Internal Revenue Code. It does business in a number of states, some of which recognize Subchapter S status and some of which do not (compl., ¶ 27; answer, ¶ 27). From FY 1998 to FY 2003 ECC paid or will pay its incurred state income taxes in those states (app. mot., ex. 1, ¶¶ 3, 4). ECC has multiple contracts with agencies of the Department of Defense (app. mot. at 3, ¶ 8).

2. The Defense Contract Audit Agency (DCAA) audited indirect rate proposals submitted by ECC for 1998 and 1999 to determine allowability and allocability of direct and indirect costs applicable to flexibly-priced contracts (R4, tab 16 at 2; tab 17 at 2).

3. DCAA disallowed proposed S corporation state income taxes included by ECC as a General & Administrative (G&A) expense. DCAA deemed them to be a "personal expense of the shareholder" and not allocable per FAR 31.201-4 (R4, tab 16 at 17; tab 17 at 14). FAR 31.201-4, DETERMINING ALLOCABILITY, states:

> A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it —
>
> (a) Is incurred specifically for the contract;
>
> (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
>
> (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

4. The audit also raised concern regarding: (1) corporate reimbursement of the shareholder's S corporation state income tax, if allocable, as excessive compensation to the shareholder; and (2) income tax payments as a distribution of profits to the shareholder (R4, tab 16 at 18; tab 17 at 14-15).

5. On 30 September 2002, ECC received DCAA Form 1-C for 1998 disallowing its owner's S corporation state income taxes (R4, tab 6). On 16 December 2002, ECC received DCAA Form 1-C for 1999 again disallowing its owner's S corporation state income taxes (R4, tab 7).

.

6. On 3 October 2002, ECC submitted a certified claim requesting a contracting officer's final decision on the allowability and allocability of S corporation state income taxes (R4, tab 8). The certified claim was revised by ECC on 26 December 2002, and again on 29 January 2003. The certified claim, as revised, included ECC's G&A pool costs which were disallowed by the DCAA for fiscal years 1998 and 1999, and also costs for fiscal years 2000 – 2004. (R4, tabs 10, 11) A footnote in the 26 December 2002 letter states:

> The figures proposed for 2003 and 2004 are the current anticipated costs as included in ECC's forward pricing rate proposals. Actuals for these years will not be known until the period is complete. Information supporting these figures was included in each years [sic] forward pricing rate proposal. Amounts for 1998 through 2001 are based upon actuals . . . .

(R4, tab 10, n.1)

7. The contracting officer's final decision was issued 14 February 2003. Therein the contracting officer stated the following:

> My decision in response to the request of ECC for a contract interpretation regarding the allowability of state income tax costs included, or yet to be included, in its final indirect cost rate proposal for each of its fiscal years, in accordance with FAR 52.216-7, Allowable Cost and Payment, is that state income tax costs of the corporation that are unallowable because of exemptions available to the corporation are not allowable and may not properly be included in ECC's G&A pool. State income taxes of the corporation that are required to be and are paid or accrued in accordance with generally accepted accounting principles and for which no exemption is available are allowable and may be included in the G&A pool.

(R4, tab 12 at 2)

8. A notice of appeal was filed and received by the Board on 24 March 2003.

9. Appellant has submitted the declaration of its comptroller, Syed Qasim, in which he states "ECC applies for and takes tax exemptions where available [and] ECC does not take exemptions from state income taxes" (app. mot., ex. 1, ¶¶ 5, 6).

10. The government has submitted portions of the tax laws of five states—Alabama, Colorado, Hawaii, New Jersey and Utah—in which appellant does business (gov't resp., appendix). In each instance, Subchapter S corporations are exempt from corporate income taxes (*id.*).

DECISION

Summary judgment is appropriate where no material facts are in dispute and the moving party is entitled to judgment as a matter of law. *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987). A material fact is one that may affect the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986). Inferences must be drawn in favor of the party opposing summary judgment. *Hughes Aircraft Co.*, ASBCA No. 30144, 90-2 BCA ¶ 22,847. In deciding a motion for summary judgment, we are not to resolve factual disputes, but to ascertain whether disputes of material facts are present. *General Dynamics Corp.*, ASBCA Nos. 32660, 32661, 89-2 BCA ¶ 21,851. In addition, we have held that "[u]nder summary judgment procedures it is usually necessary for the nonmoving party to have an adequate opportunity for discovery, and summary judgment should not be granted where the nonmovant has been denied the chance to discover information essential to its opposition." *Environmental Safety Consultants, Inc.*, ASBCA No. 53485, 03-2 BCA ¶ 32,298 at 159,808, *citing Burnside-Ott Aviation Training Center, Inc. v. United States*, 985 F.2d 1574, 1582 (Fed. Cir. 1993).

Appellant's position is that "material facts in the instant appeal relating to the payment of ECC's Subchapter S corporation taxes and allocation of such taxes to ECC's flexibly priced contracts with the Government are undisputed" and therefore summary judgment is appropriate (app. mot. at 5). First, appellant argues that state taxes of an S corporation are allowable costs pursuant to the cost principle, FAR 31.205-41, TAXES, unless expressly unallowable by paragraph (b) of the same regulation. FAR 31.205-41 states in pertinent part:

> (a) The following types of costs are allowable:
>
> (1) Federal, State, and local taxes . . . 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.

Appellant contends, and we agree, that paragraph (b) does not "expressly state that state income taxes of an S Corporation are unallowable costs" (app. mot. at 6). Appellant relies on *Information Systems & Network Corp. v. United States*, 48 Fed. Cl. 265 (2000) as having decided the issue of allowability of S corporation taxes favorably to appellant's position herein (*id*. at 6).

Second, appellant asserts its state income taxes are not tax exempt for purposes of FAR 31.205-41, which states that when a contractor pays taxes from which it is exempt, the contractor will not qualify for reimbursement, to wit:

> (b) The following types of costs are not allowable:
>
> . . . .
>
> (3) Taxes from which exemptions are available to the contractor directly . . . . The term "exemption" means freedom from taxation in whole or in part and includes a tax abatement or reduction resulting from mode of assessment, method of calculation, or otherwise.

Appellant again relies on *Information Systems* and urges the Board to adopt the analysis of the Court of Federal Claims.

Maintaining there are material facts in dispute, the government argues that appellant's statement of the issue "ignores the true 'gateway' issue in this appeal—whether the personal state income taxes of its shareholder are costs of the corporation. If they are not, then no analysis of the Taxes cost principle is necessary" (gov't reply at 1). The government asserts that ECC ignores the rule established by the Court of Appeals for the Federal Circuit, that "'cost' is equated with the amount a contractor forgoes or gives up, i.e., its economic sacrifice, to obtain goods or services." *Riverside Research Institute v. United States*, 860 F.2d 420, 422 (Fed. Cir. 1988). Accordingly, the government takes issue with whether the taxes of the shareholder are "costs" of the corporation (gov't reply at 2). It also argues that more discovery is necessary to its preparation:

> . . . The primary purpose of [the second round of discovery] is to ascertain specific facts concerning the nature of the payments for state income taxes made by ECC on behalf of its sole shareholder . . . . [including], *inter alia,* the nature of the accounts used for recording the payments, who controls those accounts, and who directed the personal state income tax payments made from those accounts. . . . [A]ll [of which] bear upon the ultimate issue of whether the payments were "costs" of the corporation for Government contracting purposes.

(Gov't reply, ex. 1, Decl. of Gregory T. Allen at 2, ¶ 7)

With regard to exemption, the government states "*arguendo* [if] the shareholder's tax liabilities [are] attributed to the corporation, there is a question of material fact as to whether ECC's [sic] has taken exemptions available to it, as required by FAR 31.205-41" (gov't resp. at 13). The government identifies as a dispute of fact whether exemptions

from state income taxes that were provided by statute in some states were taken by appellant. It bases this in part on what it refers to as the internal contradiction in the statements in finding of fact 9, *supra* (gov't resp. at 14). The government also "urges that further discovery is relevant to determination of these issues" (gov't resp. at 15). Finally, the government characterizes appellant's reliance on *Information Systems* as "misplaced" in that damages in that case are still pending before the Court of Federal Claims.

Appellant must meet two criteria to prevail. First, there must be no material fact or facts in dispute. Materiality is measured in terms of whether the disputed fact may affect the outcome. If there are no factual disputes that may affect the outcome of the case, appellant must still persuade us that it is entitled to judgment as a matter of law. As to this latter point, appellant relies heavily on *Information Systems & Networks Corp. v. United States*, 48 Fed. Cl. 265 (2000). In that opinion, which is not binding precedent for the Board, the Court said:

> . . . Although technically plaintiff is "exempt" from paying state income taxes due to its S corporation status, this is not a tax exemption in the normal sense of the term. Usually when an entity or individual is exempt from taxation, the result is the complete absence of payment of that tax, either by the exempted party or any other party. This absence of payment requirement is embodied in the term "abatement" included in the exemption definition in the Taxes Provision. § 31.205-41(b)(3).[10] In plaintiff's situation, however, the exemption is not an abatement of tax liability, but a transfer of liability. Plaintiff, as an S corporation, is not relieved of state tax liability, but is simply required to pass its liability on its corporate income to [plaintiff's shareholder]. The Taxes Provision's language does not require that any specific part of a corporation pay the state income taxes: "The following types of costs are allowable: . . . State . . . taxes . . . that are required to be and are paid. . . ." § 31.205-41(a), (a)(1). Because the state income taxes were required to be paid and were paid, and because the tax liability on the corporate income was not subject to abatement or reduction, the state income taxes claimed by plaintiff for reimbursement are allowed under the Taxes Provision.[11]

---

10. Abatement, as applied to the payment of taxes, is thus defined: "Diminution or decrease in the amount of tax imposed. Abatement

> of taxes relieves property of its share of the burdens of taxation after the assessment has been made and the tax levied." BLACK'S LAW DICTIONARY 4 (5th ed. 1979). In this case, the property involved, plaintiff's corporate income, has not been relieved of its tax burden. Instead, the property is taxed through [plaintiff's] personal tax liability instead of plaintiff's corporate tax liability.
>
> **11.** Indeed, the restriction in the Taxes Provision, precluding allowance of taxes when the contractor is exempt from such tax, § 31.205-41(b)(3), is most likely primarily designed to preclude a contractor's double recovery of taxes. A contractor that unnecessarily pays taxes to a state will undoubtedly be able to recover those payments in refunds from the state. The reimbursement of such erroneous payments as contract costs as well would unjustly enrich a contractor, therefore, as the contractor could recover the same amount from the government, as costs, and from the state tax authority, as refunds. The Taxes Provision merely cuts off the chance for such double recovery. Subsection (b)(3) of the Taxes Provision is complemented by subsection (d), which states that any taxes later refunded to a contractor from the taxing entity will be returned to the government when the government had previously reimbursed such taxes as allowable costs. In this case, however, no refund is available from the state tax authority. The taxes were not erroneously or mistakenly paid, but in fact were required to be paid. No double recovery is available here, and therefore the taxes are allowable costs under the Taxes Provision.

Id. at 270.

Assuming we were to follow *Information Systems*, and we do not decide that on this record, appellant must establish there was no dispute as to 1) the requirement for payment of the taxes, 2) actual payment of the taxes, and 3) that it exercised available entitlement to abatement. As to 3), appellant's comptroller has declared that "ECC applies for and takes tax exemptions where available [and] ECC does not take exemptions from state income taxes" (finding 9). The government argues that all three criteria are in dispute, and cites the above quotation from ECC's comptroller as an internal contradiction evincing a dispute as to whether ECC has foregone exemption, or abatement, thereby disqualifying ECC's entitlement to at least a portion of the taxes under FAR 31.205-41(b)(3).

We find the comptroller's statement ambiguous, even confusing. Does the statement that "ECC does not take exemptions from state income taxes" mean simply that it failed to take advantage of an exemption offered by a state? If so, did it pay taxes it did

not have to pay? Is the statement meant to be read in conjunction with the predecessor statement that it applied for all available exemptions, from which we are supposed to conclude that no exemptions were available? We are unable to determine just what the comptroller was trying to convey in his declaration, and conclusory affidavits are disfavored in any event. *Cf. Rosemount, Inc.*, ASBCA No. 37520, 95-2 BCA ¶ 27,770 at 138,456.

Further, we have reviewed the tax laws of five states in which ECC does business and whose taxes are at issue (finding 10). Clearly, they provide for exemptions. How, then, is it appropriate for ECC to pay those taxes directly? Moreover, is the methodology employed by ECC "in accordance with generally accepted accounting principles" as FAR 31.205-41 requires? All these questions need answers, in the Board's view. It is not appropriate for the Board in deciding a summary judgment motion to resolve factual disputes. *General Dynamics Corp., supra.* Moreover, the government is entitled to the benefit of the doubt here. *Hughes Aircraft Co., supra.* Finally, we are persuaded that the ambiguities add weight to the government's argument that it is entitled to additional discovery. *Burnside-Ott, supra.* Accordingly, we deny appellant's motion.

Dated: 13 April 2005

CARROLL C. DICUS, JR.
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

I concur

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

PETER D. TING
Administrative Judge
Acting 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. 54141, Appeal of Environmental Chemical Corporation, rendered in conformance with the Board's Charter.

Dated:

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