

AN EVALUATION OF PROPOSALS TO EX-
TEND AND AMEND THE RENEGOTIATION
ACT OF 1951: REPORT BY THE STAFF OF
JOINT COMMITTEE ON INTERNAL REVE-
NUE TAXATION

PART I: SUMMARY OF
STAFF RECOMMENDATIONS ON THE
RENEGOTIATION PROCESS

SUBMITTED TO THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

AND THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

PURSUANT TO
PUBLIC LAW 93-368



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LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, D.C., September 10, 1975.

Hon. AL ULLMAN,
Chairman, Committee on Ways and Means, House of Representatives,
Washington, D.C.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR CHAIRMEN ULLMAN AND LONG: Pursuant to Public Law 93-368, the staff of the Joint Committee on Internal Revenue Taxation is transmitting Part I ("Summary of Staff Recommendations on the Renegotiation Process") of its report on the renegotiation process to the House Committee on Ways and Means and the Senate Committee on Finance. This is the first part of a staff report that is to be submitted on or before September 30, 1975.

The summary of staff recommendations is being presented now so that the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing (which now has jurisdiction over renegotiation in the House of Representatives) will have the staff recommendations available for its consideration during the drafting of its legislative proposals for extending and amending the Renegotiation Act of 1951, as amended.

Respectfully submitted,

LAURENCE N. WOODWORTH,
Chief of Staff.

(III)

**AN EVALUATION OF PROPOSALS TO EXTEND AND
AMEND THE RENEGOTIATION ACT OF 1951: A REPORT
BY THE STAFF OF THE JOINT COMMITTEE ON IN-
TERNAL REVENUE TAXATION**

PART I:

**SUMMARY OF STAFF RECOMMENDATIONS ON THE
RENEGOTIATION PROCESS**

Basis for Staff Study

At the time of the last extension of the Renegotiation Act in 1974, both the House Ways and Means and Senate Finance Committee Reports requested that the Joint Committee staff continue its previously begun study on the renegotiation process and report to the committees in sufficient time prior to the expiration of the Act (December 31, 1975), as extended by Public Law 93-329.

Subsequent to that 18-month extension of the Renegotiation Act (June 30, 1974 to December 31, 1975), an amendment by Senator Proxmire to H.R. 8217 directed the Joint Committee staff to conduct a study of the Renegotiation Act to determine whether the Act should be extended (P.L. 93-368). If the Act were to be extended, the staff was further instructed to see how the administration of the Act could be improved, to consider whether the exemption criteria and statutory factors for determining excessive profits should be changed to make the Act "fairer and more effective and objective," and also whether the Board should be restructured. In conducting the study, the Joint Committee staff was directed to consult with the staffs of the General Accounting Office, the Cost Accounting Standards Board, the Joint Economic Committee, and the Renegotiation Board. Finally, the Joint Committee staff was instructed to submit a report to the House Ways and Means and Senate Finance Committees on or before September 30, 1975.

This is Part I ("Summary of Staff Recommendations on the Renegotiation Process") of that report as directed by Public Law 93-368. This part is being submitted prior to the remainder of the staff report so that the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing (which now has jurisdiction over renegotiation in the House) will have the recommendations available for its consideration during the drafting of its legislative proposals for extending and amending the Renegotiation Act of 1951.

(1)

Summary of Staff Recommendations

1. Extension of the Renegotiation Act

The staff believes that the Renegotiation Act should be extended for a period of at least 5 years, rather than being made permanent at this time because of the need for further congressional review as to how the Board adapts to the recommended changes in the Act and in Board organization and operation. The staff considers a shorter extension of 2 or 3 years to be too short for proper Board planning and personnel recruitment, as well as being too short a time for an evaluation of the Board's progress in responding to the recommended changes. Since a 5-year extension would place the expiration date at the end of 1980, and since 1980 is an election year, the staff recommends that the Renegotiation Act of 1951 be extended for a period of 6 years, or through December 31, 1981.

2. Agencies Covered by the Renegotiation Act

While arguments can be made for the extension of renegotiation coverage to other agencies, the staff believes that the Renegotiation Board should at this time concentrate on improving its review of Government contracts under existing agency coverage. The staff therefore recommends retaining existing law coverage at the present time, but that this be reconsidered after the Board has time to adapt to proposed changes and has had an opportunity to operate under them for a period of time. In addition, since the Atomic Energy Commission has been reorganized and divided between the Nuclear Regulatory Commission and the Energy Research and Development Administration, the staff suggests that the statute be amended to reflect the reorganization by specifically listing the two new successor agencies.

3. Statutory factors

Based upon conclusions that the existing statutory factors are generally appropriate for consideration by the Board in determining whether a contractor had realized excessive profits, and that the principal problem under present law concerns the application of the existing factors in the renegotiation process, the staff recommends that—

(1) The Board be directed to issue written guidelines describing in detail the principles which will be employed in applying the statutory factors. Before final adoption and implementation, however, the Board's proposed guidelines should be submitted to Congress not later than June 30, 1976, in order to permit consideration of the need for further legislation prior to their adoption. Further, the Board should be directed to include guidelines in further elaboration of the manner in which the special problems of small business will be taken into account and the manner and extent to which an agency's negotiating policies, including the "weighted guidelines" used for pricing purposes, will be taken into account.

(2) The "reasonableness of costs and profits" factor be amended to provide that, in determining excessive profits for a fiscal year, the profitability of the preceding three fiscal years and the next succeeding fiscal year be considered by the Board.

(Under present law, the Board considers "deficient" profits for prior fiscal years in a limited number of situations. This modification of the

statutory factor would enable the Board to alleviate inequities which arise from fiscal year renegotiation in a wider range of situations.)

(3) The so-called "net worth" factor under section 103(e)(2) of the Act be revised by striking out "net worth" and referring only to "capital employed."

(4) A technical language change is recommended to change the phrase "war and peacetime products" to "renegotiable and non-renegotiable products and services."

4. Accounting standards

(1) The staff recommends that the general application of tax accounting standards be continued at the present time for the purpose of determining the "allowability" of costs and expenses.

This recommendation is based primarily upon practical and administrative considerations. The staff is aware that tax accounting standards may not be entirely satisfactory for renegotiation purposes. However, in light of the body of tax law and rules and regulations which have developed, the application of the tax accounting standards will generally provide more definitive rules and result in more uniform treatment of contractors than would be the case with the application of general accounting principles or under the Armed Services Procurement Regulations (ASPR). Moreover, it is noted that the principal focus of the ASPR rules is related to pricing on a contract-by-contract basis rather than to the aggregate fiscal year profits of a contractor. In addition, continuation of the tax accounting standards would provide some audit backup by a Government agency (the IRS) which would not otherwise be available. Moreover, the Board will continue to have authority (as under present law) to consider the effect of tax accounting under the "reasonableness of costs" statutory factor and to prescribe rules relating to the "allocation" of costs to renegotiable business, without regard to the question of "allowability" for tax accounting purposes.

(2) The staff also recommends that the Board be given the authority to prescribe regulations for selective exemption from the application of specific rules prescribed by the Cost Accounting Standards Board whenever the Renegotiation Board determines that a conflict exists between application of tax accounting standards and a cost accounting standard.

5. Exemptions

The staff recommends that the following exemptions be repealed:

- (1) Standard commercial articles and services;
- (2) Competitively-bid construction contracts; and
- (3) New durable productive equipment.

If the exemption for standard commercial articles and services is not repealed, the staff suggests that the exemption be tightened by removing the "class" exemption and the "waiver of exemption" provision, and by raising the percentage test from 55 percent to 70 or 75 percent. Also, it is suggested that the percentage test be modified to exclude sales to noncovered Government agencies as qualifying for the minimum percentage.

In addition, the staff recommends that the Board be directed to evaluate the raw materials exemptions and the related question of the "cost

allowance" provision for integrated firms, and to report directly to the Congress not later than June 30, 1976.

6. *Classification of contractor sales*

The staff recommends that—

(1) The Act be amended to codify the Board's position that it has the authority to analyze renegotiable business by product line, profit center, segment or division, but that, generally, the final determination of excessive profits be made on an overall fiscal year basis by aggregating such product lines, profit centers, segments or divisions.

(2) As an exception to the general rule for aggregation for a fiscal year, the Board be given discretionary authority to make a final excessive profit determination on a product line, profit center, segmental or divisional basis where there are clear reasons for making such a determination—for example, where renegotiation on an aggregate fiscal year basis would result in allowing an offset against excessive profits for losses or below normal profits arising from an acquisition of another business, or adoption of a pricing policy, with the objective of eliminating competition and thereby becoming the sole source supplier of a product or service.

7. *Floor levels*

The staff recommends that the \$1,000,000 general floor not be changed at the present time; however, the staff does recommend that the \$25,000 floor for brokers and agents be raised to \$50,000.

8. *Minimum refund level*

The staff recommends that the Renegotiation Board be directed not to set any specified minimum refund level (an amount below which excessive profits determinations will not be pursued). Under the Board's present regulations, determinations of excessive profits below \$80,000 (\$20,000 for brokers and agents) are not pursued by the Renegotiation Board although this practice is not specifically authorized by statute. The staff has concluded that there are no justifiable reasons for setting a particular minimum level of excessive profits that will not be pursued. If the Board determines such levels are "excessive," then the contractor should not be allowed to avoid payment.

9. *Board structure*

The staff believes that the Board should remain as an independent agency within the Executive Branch; nevertheless, during the 6-year extension period, it is recommended that the Board be required to (1) submit any budget or other legislative proposals to Congress at the time of submission to the Office of Management and Budget, and (2) make detailed, periodic reports to Congress on operations and changes in organization and procedure in addition to the largely statistical annual reports the Board now makes to Congress.

10. *Board organization and membership*

The staff recommends:

- (1) 5-year staggered terms for Board members;
- (2) providing that when a member's term has expired, the member is to continue to serve until a new member (or the reappointed

member) is ready to assume office, but in no event longer than 6 months;

(3) providing that the President is to designate a member of the Board to serve as Chairman;

(4) limiting the number of Board members of one political party affiliation to three;

(5) providing statutory administrative powers for the Chairman; and

(6) raising the salary of the Chairman to one level above that of the other Board members.

11. *Board budget and staffing*

The staff believes that there is a need to increase the Board's staff in order to reduce the case backlog and to expedite the handling of cases assigned: more specifically, the staff recommends an increase in the Board's research and planning staff to work on guidelines for the statutory factors and other staff research matters; additional personnel in the screening process to provide a more thorough review of filings for possible assignment to regional offices for further analysis; strengthening the economic analysis capability (headquarters and regional offices) to assist in providing more concrete economic analysis in Board opinions and in developing industry economic analysis; and additional legal staff to allow the General Counsel's office to follow more closely cases referred to the Department of Justice as well as cases tried in the Court of Claims.

12. *Board field organization*

While it is probable that the Board needs more regional personnel (and possibly additional offices), the Board needs to have additional time to adapt to any legislative changes and to evaluate the resulting impact on procedures and workload. In view of the staff's recommendation for the Board to review the possible application of the Administrative Procedures Act (No. 16, below), the staff suggests that such a review include the possible impact on the regional board procedures and organization. The staff further suggests that the Board be directed to report directly to Congress not later than June 30, 1976, on the need for additional regional offices to adequately and expeditiously process cases.

13. *Penalties for late filing*

The staff recommends that civil penalties of \$100 per day be set for late filing of required financial statements (up to a maximum of \$100,000) for any given year's return, and that similar penalties be provided for failure to provide requested data and information. However, it is further recommended there be procedures for an abatement of a penalty for reasonable cause and for appealing such a penalty in court.

14. *Subpoena power*

The staff recommends that the Board be given subpoena power for books and records, with enforcement through a Federal District Court where the contractor for any reason fails to obey the subpoena. Further, the staff recommends that only a majority of either the statutory

Board, a "division" of the Board, or of a regional board be authorized to issue a subpoena.

15. Interest charged on redeterminations

The staff recommends that on excessive profit determinations, the interest charge commence 30 days after a regional board has issued either a final opinion or has notified the contractor of its recommendation of an excessive profit determination. In addition, it is recommended that interest should be charged for previous periods where the contractor has delayed renegotiation because of failure to file returns or submit requested information on a timely basis.

16. Contractor appeals procedure

The staff recommends that no change be made at the present time with respect to the contractor appeals procedure. However, the staff further recommends that the Board be directed to evaluate the effect of applying the Administrative Procedure Act to the Board (including possible application to regional boards), and to report its findings and recommendations directly to the Congress not later than June 30, 1976.

The staff is aware that application of the Administrative Procedure Act would beneficially affect certain aspects of renegotiation and adversely affect other aspects. The beneficial effects would include providing due process for contractors, requiring the development of case records, promoting the issuance of better decisions, and alleviating the costliness of litigation if the Court of Claims review were in the nature of an appellate review rather than a *de novo* trial. The adverse effects would include aggravating the case backlog problem (since development of the case record would be more time consuming) and increasing the costs of proceedings before the Board. In view of these considerations, the staff believes that the Board should be given an opportunity to study the impact of applying the Administrative Procedure Act to its proceedings, and to report its findings to the Congress.

17. Court jurisdiction

The staff believes that the Court of Claims should retain jurisdiction over renegotiation cases.

(Part II of the staff's report will include an analysis of the reasons for the differences in settlement levels since the jurisdiction was changed from the Tax Court to the Court of Claims.)

18. Bonding requirement

Attorneys active in renegotiation proceedings have recommended eliminating or modifying the requirement that a bond be posted by any plaintiff appealing a determination of excessive profits to the Court of Claims. They argue that this may prevent a contractor in financial difficulty from obtaining a court hearing because a bond posted directly with the court must be in the full net amount of the determination (the amount of the determination less the estimated Federal tax credit that would result from refund of the profits in question), while a bond obtained from a surety company must normally be fully collateralized in the amount of the determination.

However, the staff has been informed by the Justice Department that it presently has a procedure of entering a judgment for the bond

amount and then working out a payment schedule with the contractor, which allows the contractor to go to court while he is making payments on the judgment for the bond. Therefore, the staff concludes that no statutory change is necessary to give the contractor his day in court. Moreover, the viable alternatives to the present procedure (such as placing a lien on the contractor's property) would offer little, if any, added relief to the contractor than is now available under present procedures.

19. Loss carryback

The staff recommends that loss carrybacks not be allowed (but see item No. 3, above).

20. Averaging of profits

The staff does not recommend the adoption of a specific formula for the averaging of profits. (However, as indicated above, the staff recommends an amendment to the "reasonableness of costs and profits" statutory factor to provide for consideration of the profitability of certain fiscal years preceding and succeeding the fiscal year under review.)

21. Annual GAO report on renegotiation

The staff believes that there is no need to require the GAO to review and report on renegotiation on an annual basis, since the GAO will make whatever reviews and reports the Congress requests from time to time.

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