

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Parts 16, 22, 31, 37, and 52**

[FAR Case 2001-008]

RIN 9000-AJ36

**Federal Acquisition Regulation;
Compensation Cost Principle**

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Proposed rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the Federal Acquisition Regulation (FAR) to revise the "compensation for personal services" cost principle.

DATES: Interested parties should submit comments in writing on or before June 24, 2002 to be considered in the formulation of a final rule.

ADDRESSES: Submit written comments to: General Services Administration, FAR Secretariat (MVP), 1800 F Street, NW, Room 4035, ATTN: Laurie Duarte, Washington, DC 20405.

Submit electronic comments via the Internet to: farcase.2001-008@gsa.gov

Please submit comments only and cite FAR case 2001-008 in all correspondence related to this case.

FOR FURTHER INFORMATION CONTACT: The FAR Secretariat, Room 4035, GS Building, Washington, DC, 20405, at (202)

501-4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Jeremy Olson at (202) 501-3221. Please cite FAR case 2001-008.

SUPPLEMENTARY INFORMATION:**A. Background**

The Councils performed an analysis of the cost principle at FAR 31.205-6, Compensation for personal services. This analysis excluded a review of the paragraphs of the cost principle addressing pension costs (paragraph (j)), deferred compensation other than pensions (paragraph (k)), and postretirement benefits other than pensions (paragraph (o)), which the Councils are planning to review at a later date under a separate FAR case.

Specifically, the proposed rule revises FAR 31.205-6 by—

1. Adding a definition for "compensation for personal services" at FAR 31.001, Definitions;

2. Removing as unnecessary the listing of examples of specific types of compensation currently located at FAR 31.205-6(a);

3. Clarifying and moving the current FAR 31.205-6(b)(2)(i) to a new paragraph FAR 31.205-6(a)(6), and expanding the new paragraph to cover members of "limited liabilities companies" since their compensation also requires special consideration;

4. Revising paragraph (b) to consolidate all reasonableness provisions, including those dealing with labor-management agreements that are currently addressed at FAR 31.205-6(c);

5. Deleting the language that places the burden of demonstrating reasonableness on the contractor, currently found in FAR 31.205-6(b)(1) because it is redundant of language currently found in FAR 31.201-3(a). By removing this language, the Councils are not intending to imply that this burden has shifted to the Government;

6. Rewriting paragraph (h), as new paragraph (g), entitled "Backpay" to improve its clarity, without changing its meaning, and to emphasize that backpay for underpaid work is the only allowable retroactive adjustment, except as may be specifically listed in the paragraph; and

7. Making other changes to clarify, improve the structure, and remove redundancies throughout the cost principle.

This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

B. Regulatory Flexibility Act

The Councils do not expect this proposed rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because most contracts awarded to small entities use simplified acquisition procedures or are awarded on a competitive, fixed-price basis and do not require application of the cost principle discussed in this rule. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. We invite comments from small businesses and other interested parties. The Councils will consider comments from small entities concerning the affected FAR parts 16, 22, 31, 37, and 52 in accordance with 5 U.S.C. 610. Interested parties must

submit such comments separately and should cite 5 U.S.C. 601, *et seq.* (FAR case 2001-008), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

List of Subjects in 48 CFR Parts 16, 22, 31, 37, and 52

Government procurement.

Dated: April 16, 2002.

Al Matera,

Director, Acquisition Policy Division.

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 16, 22, 31, 37, and 52 as set forth below:

1. The authority citation for 48 CFR parts 16, 22, 31, 37, and 52 continues to read as follows:

Authority: 40 U.S.C. 486(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 16—TYPES OF CONTRACTS**16.203-4 [Amended]**

2. Amend section 16.203-4 in paragraph (c)(4)(ii) by removing "31.205-6(m)" and adding "31.205-6(l)" in its place.

**PART 22—APPLICATION OF LABOR
LAWS TO GOVERNMENT
ACQUISITIONS****22.101-2 [Amended]**

3. Amend section 22.101-2 in the last sentence of paragraph (a) by removing "31.205-6(c)" and adding "31.205-6(b)" in its place.

**PART 31—CONTRACT COST
PRINCIPLES AND PROCEDURES**

4. Amend section 31.001 by adding, in alphabetical order, the definition "Compensation for personal services" to read as follows:

31.001 Definitions.

* * * * *

Compensation for personal services means all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor.

* * * * *

31.201-5 [Amended]

5. Amend section 31.201-5 in the last sentence by removing "31.205-6(j)(4)" and adding "31.205-6(i)(4)" in its place.

6. Amend section 31.205-6 by—
a. Revising paragraphs (a) and (b);

- b. Removing paragraph (c);
- c. Redesignating paragraphs (d) through (p) as paragraphs (c) through (o), respectively;
- d. Revising newly designated paragraphs (c) through (g);
- e. Removing from newly designated paragraph (h)(3) "paragraph (i)" and adding "paragraph (h)" in its place;
- f. Removing from the last sentence of newly designated paragraph (i)(2) introductory text the words "(j)(2)(i) and (j)(3)" and adding "(i)(2)(i) and in paragraphs (i)(3)" in its place; removing from paragraph (i)(2)(iii) "(j)(7)" and adding "(i)(7)" in its place; removing from the second sentence of paragraph (i)(3)(v) introductory text "(j)(4)" and adding "(i)(4)" in its place; removing from the last sentence of paragraph (i)(4)(ii) "paragraph (j)(4)(ii)" and adding "paragraph (i)(4)(ii)" in its place; removing from the last sentence of paragraph (i)(5) introductory text "(j)(1)" and adding "(i)(1)" in its place; removing from paragraph (i)(5)(ii) "(j)(3)(ii)" and adding "(i)(3)(ii)" in its place; removing from the last sentence of paragraph (i)(7) introductory text "subdivisions (j)(3)(i)" and adding "paragraphs (i)(3)(i)" in its place; and by removing from paragraph (i)(8)(iii) "subdivision (j)(3)(i) above" and adding "paragraph (i)(3)(ii) of this subsection" in its place;
- g. Removing from newly designated paragraph (n)(2) "(o)(2)(i)" and adding "(n)(2)(i)" in its place, and removing "section" and adding "subsection" in its place;
- h. Removing from the first sentence of newly designated paragraph (n)(5) "(o)(2)(iii)" and adding "(n)(2)(iii)" in its place;
- i. Removing from the last sentence of newly designated paragraph (o)(1) introductory text "(p)(2)(ii)" and adding "(o)(2)(ii)" in its place; removing the colon at the end of paragraph (o)(2) introductory text and adding an em-dash (—) in its place, and by removing from paragraph (o)(2)(i) "(j)(5) and (j)(8)" and adding "(i)(5) and (i)(8)" in its place.

The revised text reads as follows:

31.205–6 Compensation for personal services.

(a) *General.* Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or

wages (but see paragraphs (f), (g), (i), (j), (l), and (n) of this subsection).

(2) The total compensation for individual employees or job classes of employees must be reasonable for the work performed; however, specific restrictions on individual compensation elements apply when prescribed.

(3) The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor has not provided the cognizant ACO, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 are not allowable under this subsection 31.205–6 solely on the basis that they constitute compensation for personal services.

(6) The cognizant ACO must—

(i) Give special consideration to—

(A) Owners of closely held corporations, members of limited liability companies, partners, sole proprietors, or members of their immediate families; and

(B) Persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise.

(ii) Ensure that compensation costs covered by this paragraph are not—

(A) A distribution of profits, which is not an allowable contract cost; and

(B) In excess of costs that are deductible as compensation under the Internal Revenue Code (26 U.S.C.) and regulations under it.

(b) *Reasonableness*—(1)

Compensation pursuant to labor-management agreements. If costs of compensation established under "arm's length" labor-management agreements negotiated under the terms of the Federal Labor Relations Act or similar state statutes are otherwise allowable, the costs are reasonable unless, as applied to work in performing Government contracts, the costs are unwarranted by the character and circumstances of the work or discriminatory against the Government.

The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (e.g., work involving extremely hazardous activities or work not requiring

recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (e.g., work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances.

(2) *Compensation not covered by labor-management agreements.*

Compensation for each employee or job class of employees must be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation, consider only allowable individual elements of compensation. In addition to the provisions of 31.201–3, in testing the reasonableness of compensation for particular employees or job classes of employees, consider factors determined to be relevant by the contracting officer. Factors that may be relevant include, but are not limited to, conformity with compensation practices of other firms—

- (i) Of the same size;
- (ii) In the same industry;
- (iii) In the same geographic area; and
- (iv) Engaged in similar non-Government work under comparable circumstances.

(c) *Form of payment.* (1)

Compensation for personal services includes compensation paid or to be paid in the future to employees in the form of—

- (i) Cash;
- (ii) Corporate securities, such as stocks, bonds, and other financial instruments (see paragraph (c)(2) of this subsection regarding valuation; or
- (iii) Other assets, products, or services.

(2) When compensation is paid with securities of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the securities is the fair market value on the first date the number of shares awarded is known, determined upon the most objective basis available.

(ii) Accruals for the cost of securities before issuing the securities to the employees are subject to adjustment according to the possibilities that the employees will not receive the securities and that their interest in the accruals will be forfeited.

(d) *Income tax differential pay.* (1) Differential allowances for additional

income taxes resulting from foreign assignments are allowable.

(2) Differential allowances for additional income taxes resulting from domestic assignments are unallowable.

(e) *Bonuses and incentive compensation.* (1) Bonuses and incentive compensation based on production, cost reduction, or efficient performance are allowable provided the—

(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and

(ii) Basis for the award is supported.

(2) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of paragraphs (e)(1) and (j) of this subsection.

(f) *Severance pay.* (1) Severance pay is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in paragraph (i)(7) of this subsection.

(2) Severance pay is allowable only to the extent that, in each case, it is required by—

(i) Law;

(ii) Employer-employee agreement;

(iii) Established policy that constitutes, in effect, an implied agreement on the contractor's part; or

(iv) Circumstances of the particular employment.

(3) Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable.

(4) Abnormal or mass severance pay is of such a conjectural nature that accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, the Government

will consider allowability on a case-by-case basis.

(5) Under 10 U.S.C. 2324(e)(1)(M) and 41 U.S.C. 256(e)(1)(M), the costs of severance payments to foreign nationals employed under a service contract performed outside the United States are unallowable to the extent that such payments exceed amounts typically paid to employees providing similar services in the same industry in the United States. Further, under 10 U.S.C. 2324(e)(1)(N) and 41 U.S.C. 256(e)(1)(N), all such costs of severance payments that are otherwise allowable are unallowable if the termination of employment of the foreign national is the result of the closing of, or the curtailment of activities at, a United States facility in that country at the request of the government of that country; this does not apply if the closing of a facility or curtailment of activities is made pursuant to a status-of-forces or other country-to-country agreement entered into with the government of that country before November 29, 1989. 10 U.S.C. 2324(e)(3) and 41 U.S.C. 256(e)(2) permit the head of the agency to waive these cost allowability limitations under certain circumstances (see 37.113 and the solicitation provision at 52.237-8).

(g) *Backpay.* Backpay is a retroactive adjustment of prior years' salaries or wages. Backpay is unallowable except as follows:

(1) Payments to employees resulting from underpaid work actually performed are allowable, if required by a negotiated settlement, order, or court decree.

(2) Payments to union employees for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiation are allowable.

(3) Payments to nonunion employees based upon results of union agreement negotiation are allowable only if—

(i) A formal agreement or understanding exists between management and the employees concerning these payments; or

(ii) An established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payments.

* * * * *

31.205-7 [Amended]

7. Amend section 31.205-7 in the last sentence of paragraph (c)(2) by removing "31.205-6(g)" and adding "31.205-6(f)" in its place.

31.205-13 [Amended]

8. Amend section 31.205-13 in the last sentence of paragraph (b) by removing "31.205-6(f)" and adding "31.205-6(e)" in its place.

31.205-46 [Amended]

9. Amend section 31.205-46 in the last sentence of paragraph (f) by removing "31.205-6(m)(2)" and adding "31.205-6(l)(2)" in its place.

PART 37—SERVICE CONTRACTING

10. Amend section 37.113-1 by revising the introductory text of paragraph (a) to read as follows:

37.113-1 Waiver of cost allowability limitations.

(a) The head of the agency may waive the 31.205-6(f)(5) cost allowability limitations on severance payments to foreign nationals for contracts that—

* * * * *

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

52.215-18 [Amended]

11. Amend section 52.215-18 by removing from the clause heading "(OCT 1997)" and adding "(DATE)" in its place; and by removing from the second sentence of the clause "31.205-6(o)(6)" and adding "31.205-6(n)(6)" in its place.

52.237-8 [Amended]

12. Amend section 52.237-8 by removing from the provision heading "(OCT 1995)" and adding "(DATE)" in its place; and by removing from paragraph (a) of the provision "31.205-6(g)(3)" and adding "31.205-6(f)(5)" in its place.

52.237-9 [Amended]

13. Amend section 52.237-9 by removing from the clause heading "(OCT 1995)" and adding "(DATE)" in its place; and by removing from paragraph (a) of the clause "31.205-6(g)(3)" and adding "31.205-6(f)(5)" in its place.

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