

Federal Contractors May Be Blindsided by the Reach of State Sales and/or Use Taxes

Traditionally, many federal contracts contain tax exemption provisions relating to state sales and use taxes being charged against the purchase and inclusion of materials and equipment to be incorporated into federal projects. In such circumstances, the federal government will inform the bidders/offerors of its application of this exemption and provide a tax exemption certificate. In other procurement, the federal government will agree to reimburse such taxes. These options occur on a contract-by-contract basis. That being said, contractors purchasing materials and tangible personal property used in the performance of a federal contract must pay careful attention to state tax laws, which vary across the country. *Alstom Power, Inc.*,¹ a March 28, 2023, decision from the Washington State Court of Appeals, highlights this challenge and its potential impact on a federal contractor's earnings.

Alstom Power Inc., the contractor, was hired by the federal government to perform multi-year hydroelectric turbine rehabilitation work on the Chief Joseph Dam, a large hydroelectric dam operated by the U.S. Army Corps of Engineers (a federal agency). Alstom subcontracted with its international affiliates in France and Canada to design, engineer, manufacture, and rehabilitate turbine components and paid the affiliates for their work. Alstom then reassembled and installed the turbine units in Washington State.

The Washington State Department of Revenue (Department) audited Alstom. The Department not only required Alstom to pay use tax on the cost of the raw materials used for the turbine components but also required the company to pay use tax for the design and engineering (i.e., service) costs associated with the turbine components. In doing so, the Department considered design and engineering costs to be part of the total value of the turbine components purchased by Alstom.

Alstom disagreed with the Department's findings on several grounds and appealed to the Washington State Board of Tax Appeals (Board). The Board agreed with the Department's assessment but determined that design and engineering costs incurred *prior* to the Army Corps' authorizing the turbine design were not part of the value of the turbine components for tax purposes. Both Alstom and the Department appealed portions of the Board's ruling to the Washington State Court of Appeals.

The Washington State Court of Appeals held that design and engineering costs were part of the value of the turbine components and should be subject to the state's use tax; rejecting an argument from Alstom that the use tax could not be imposed on work performed outside of Washington. The court also determined that the use tax applied both to the design and engineering costs performed after the Army Corps authorized the design and to design and engineering costs incurred before the authorization was granted.

This case is a reminder that federal contractors should be aware of the state tax rules governing their projects/contracts so they properly can estimate their costs and make well-informed bids. Sometimes this is straightforward and, as the *Alstom* decision shows, other times is anything but; however, having this knowledge "up front" or asking questions of the agency as to the contract's taxation status ensures that the contractor avoids pitfalls such as surprise tax assessments. As Alstom learned, it is harder to discern how agencies and courts may interpret the relevant tax statutes and regulations, making it difficult to project costs and earnings with a reasonable degree of certainty.



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¹ *Alstom Power, Inc. et al. v. State of Washington Department of Revenue*, Civ No. 56476-9-II, Washington State Court of Appeals (March 28, 2023).