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Contracting with Inverted Domestic Corporations: Answers to Frequently Asked Questions

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Summary

Recent reports that certain entities continued to receive federal government contracts after reincorporating overseas have prompted questions about current and proposed restrictions on contracting with “inverted domestic corporations.” These questions are shaped, in part, by the broader debate over whether such corporations are to be seen as “deserters,” who change their corporate citizenship to avoid paying U.S. taxes, or as evidencing systemic problems in the U.S. tax code. However, they also reflect a long-standing debate over whether the federal procurement process should be used to promote particular socioeconomic goals which some assert are tangential to the primary purpose of the procurement process (i.e., acquiring the supplies and services that best meet the government’s needs at the lowest price).

Congress has sought to discourage corporate inversions by barring certain contracts with inverted domestic corporations ever since it enacted the Homeland Security Act of 2002 (P.L. 107-296, §835). As amended, this act prohibits the Department of Homeland Security from awarding a contract to an inverted domestic corporation, or a subsidiary thereof, unless the Secretary of Homeland Security determines that a waiver is necessary in the interest of national security. The act also establishes its own definition of *inverted domestic corporation*, which is different from that in the Internal Revenue Code. Subsequent legislation imposed similar prohibitions upon other agencies, although only as to funds appropriated or otherwise made available under specific acts of Congress. However, some commentators have argued that inverted domestic corporations have continued to receive federal contracts because of “loopholes” or “gaps” in these measures. Thus, some Members of the 113th Congress have proposed legislation—or requested executive action—to reduce or remove opportunities for inverted domestic corporations to receive government contracts.

This report provides the answers to 14 frequently asked questions regarding the current restrictions on contracting with inverted domestic corporations, proposed amendments thereto, and the relationship between prohibitions upon contracting with inverted domestic corporations and other provisions of law that restrict dealings with “foreign” contractors.

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Recent reports that certain entities continued to receive federal government contracts after reincorporating overseas have prompted questions about current and proposed restrictions on contracting with “inverted domestic corporations.”¹ These questions are shaped, in part, by the broader debate over whether such corporations are to be seen as “deserters,” who change their corporate citizenship to avoid paying U.S. taxes, or as evidencing systemic problems in the U.S. tax code.² However, they also reflect a long-standing debate over whether the federal procurement process should be used to promote particular socioeconomic goals that one court described as “only indirectly related to conventional procurement considerations” (i.e., acquiring the supplies and services that best meet the government’s needs at the lowest price).³

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This report provides the answers to 14 frequently asked questions regarding the current restrictions on contracting with inverted domestic corporations, proposed amendments thereto,

¹ See, e.g., Zachary R. Mider, How to Win Billions in Federal Contracts on a Permanent Tax Holiday, Bloomberg, July 8, 2014, available at <http://www.bloomberg.com/news/2014-07-08/tax-runaways-win-billions-in-u-s-contracts-despite-bans.html>; Stephen Koff, Eaton Corp. Gets Millions in U.S.-Taxpayer-Funded Contracts, Despite Its Move to Low-Tax Ireland, Cleveland Plain Dealer, July 30, 2014, available at http://www.cleveland.com/open/index.ssf/2014/07/eaton_corp_gets_millions_in_us.html.

² See generally CRS Legal Sidebar WSLG1067, Treasury’s Actions on Corporate Inversions, by Erika K. Lunder and Carol A. Pettit.

³ *Rossetti Constr. Co. v. Brennan*, 508 F.2d 1036, 1045 n.18 (7th Cir. 1975) (“It is well established that the procurement process, once exclusively concerned with price and quality of goods and services, has been increasingly utilized to achieve social and economic objectives only indirectly related to conventional procurement considerations.”). However, while some may suggest that procurement decisions once focused exclusively upon price and quality, Congress, in particular, has long sought to leverage procurement spending to promote socio-economic goals. See, e.g., James F. Nagle, *A HISTORY OF GOVERNMENT CONTRACTING* 57-58 (2d ed., 1999) (describing how the Continental Congress used contracts for the mail to promote development of interstate passenger transportation).

⁴ See generally 6 U.S.C. §395(a)-(c).

⁵ See 6 U.S.C. §395(d).

⁶ See *infra* “What restrictions are there on contracting with inverted domestic corporations?”.

⁷ See Zachary R. Mider, *Ingersoll-Rand Finds Escaping U.S. Tax Carries No Penalty as Contracts Flow*, 102 FED. CONT. REP. 67 (July 15, 2014) (noting, among other things, that Ingersoll-Rand can “garner contracts that aren’t funded by annual congressional appropriations,” and received “contracts during periods when the ban had temporarily expired”).

⁸ See *infra* “How do H.R. 5278 and S. 2704 differ from the current provisions?,” and “Could the President bar contracting with inverted domestic corporations without congressional action?”.

and the relationship between prohibitions upon contracting with inverted domestic corporations and other provisions of law that restrict dealings with “foreign” contractors.

Current Restrictions

Many questions pertain to the current restrictions on contracting with inverted domestic corporations, including (1) the nature of the restrictions, (2) what constitutes an inverted domestic corporation for purposes of the restrictions, and (3) whether the restrictions can be waived. This section provides answers to these and other questions.

What restrictions are there on contracting with inverted domestic corporations?

Several different provisions of federal law bar government agencies from awarding “contracts” to inverted domestic corporations or their subsidiaries. (See “To what types of contracts does the proposed legislation apply?” for further discussion of what is meant by *contract* here.) However, each provision in current law applies to different federal agencies and/or funds.

The earliest provision, and the only one that is permanent law, applies to the Department of Homeland Security (DHS). As initially enacted, Section 835 of the Homeland Security Act of 2002 (P.L. 107-296) generally barred DHS from contracting with any “foreign incorporated entity” that met the definition of *inverted domestic corporation* given by the act. (See “Can the restrictions be waived?” for a discussion of waivers of this prohibition.) Subsequently, Section 835 was amended (P.L. 108-334, §523) to bar contracting with subsidiaries of inverted domestic corporations, as well as the corporations themselves.⁹

Subsequent measures have generally been modeled on the Homeland Security Act, although their restrictions apply only to specific funds.¹⁰ Initially, the measures reached funds “appropriated or otherwise made available” to specified agencies under particular acts, such as the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006 (P.L. 109-115, §724). Subsequent measures, though, were “consolidated” or “omnibus” ones that generally applied government-wide, as was the case with Section 738 of the Consolidated Appropriations Act, 2012 (P.L. 112-74).¹¹

⁹ The meaning of the term *subsidiary* is not defined in the Homeland Security Act or any subsequent enactment modeled on it. However, the Federal Acquisition Regulation (FAR) defines *subsidiary*, for purposes of this prohibition, as “an entity in which more than 50 percent of the entity is owned (1) [d]irectly by a parent corporation; or (2) [t]hrough another subsidiary of a parent corporation.” 48 C.F.R. §9.108-1.

¹⁰ The earlier appropriations riders applied only to funds appropriated or otherwise made available by that act (e.g., P.L. 109-115, §724(a)). Later measures refer to funds under “this or any other Act” (e.g., P.L. 112-74, §738(a)). However, the language regarding “any other Act” applies only to appropriations acts of the same year. It has not been construed as applying to subsequent years’ appropriations, apparently on the grounds that there is nothing indicating that “Congress intended it to be permanent.” Gov’t Accountability Office, *PRINCIPLES OF FEDERAL APPROPRIATIONS LAW*, vol. I, at 2-34 (3d ed. 2004) (giving examples of so-called “language of futurity” that can overcome the presumption that provisions in appropriations acts are not intended to be permanent).

¹¹ Similar prohibitions were included in Section 743 of the Omnibus Appropriations Act, 2009 (P.L. 111-8) and Section 740 of the Consolidated Appropriations Act, 2010 (P.L. 111-117).

These statutory restrictions are implemented through Subpart 9.1 of the Federal Acquisition Regulation (FAR) and agency FAR supplements.¹² However, the FAR does not impose any restrictions on contracting with inverted domestic corporations that do not have a basis in statute.

What constitutes an inverted domestic corporation for purposes of these restrictions?

For purposes of these restrictions, a foreign corporation is an inverted domestic corporation if it acquires “substantially all” of the properties held by a U.S. corporation and, after the inversion, at least 80% of its stock is owned, by vote or value, by former shareholders of the U.S. corporation by reason of their holding stock in the U.S. corporation (in other words, there is not a significant change in ownership post-inversion).¹³ However, an entity is not treated as an inverted domestic corporation if, post-inversion, the foreign corporation and its expanded affiliated group (the companies connected to it by at least 50% ownership)¹⁴ have “substantial business activities” in its home country when compared to the group’s total business activities. There are analogous rules for partnerships.

This definition of “inverted domestic corporation” is based on Section 7874 of the Internal Revenue Code (IRC), which treats corporations meeting these criteria as domestic corporations for U.S. tax purposes, thus significantly limiting the tax benefits of the inversion. However, there are differences between the contracting restrictions and the IRC provision. For example, the IRC provision applies only to inversions completed after March 3, 2003, while the contracting restrictions contain no such limitation. Another key difference is that, while both have the 80% ownership threshold, the IRC provision also captures situations where the former shareholders of the U.S. corporation own between 60% and 80% of the foreign corporation after the inversion (in these cases, the entity is treated as foreign but limited in its ability to claim credits and deductions). Furthermore, the Internal Revenue Service (IRS) has promulgated regulations defining and clarifying certain terms and concepts for purposes of IRC Section 7874, which are not applicable to the contracting prohibitions. For example, IRS regulations define “substantial business activities” to mean that at least 25% of the expanded affiliate group’s employees, employee compensation, assets, and income must be in or derived from the foreign country.¹⁵

¹² The FAR is a regulation, codified in Parts 1 through 53 of Title 48 of the Code of Federal Regulations (C.F.R.), that generally governs the procurements of executive branch agencies. Individual agencies may issue their own regulations that supplement the FAR. However, these regulations may conflict or be inconsistent with the FAR only if required by law, or if the agency has used an authorized deviation. For more on the FAR and agency FAR supplements, see generally CRS Report R42826, *The Federal Acquisition Regulation (FAR): Answers to Frequently Asked Questions*, by Kate M. Manuel et al.

¹³ 5 U.S.C. §395(b); 48 C.F.R. §9.108-1.

¹⁴ Specifically, an “expanded affiliated group” consists of corporations connected through stock ownership when (1) the common parent directly owns at least 50% of the stock, by vote and value, of at least one other member of the group, and (2) at least 50% of the stock, by vote and value, in each of the members is owned directly by one or more other group members. See 26 U.S.C. §1504.

¹⁵ 26 C.F.R. §1.7874-3T. Notably, the term “substantial business activity” has been difficult for the IRS to define, with the agency changing its interpretation three times between 2006 and 2012. Initially, the regulations provided that the determination of “substantial business activity” was made by looking at the facts and circumstances of each case, but provided a safe harbor if at least 10% of the expanded affiliated group’s employees, assets, and sales were in the foreign country. In 2009, the IRS deleted the safe harbor due to concerns that companies were taking advantage of it. Then in 2012, the IRS replaced the facts and circumstances test with the bright line 25% threshold, explaining its belief that this “will provide more certainty in applying ... and improve the administrability of” Section 7874. Dep’t of the (continued...)

Can the restrictions be waived?

All the restrictions on contracting with inverted domestic corporations have provided for waivers, although the circumstances in which such waivers are permitted have varied in different enactments. Initially, Section 835 of the Homeland Security Act of 2002 (P.L. 107-296) provided that the prohibition “shall” be waived if the Secretary of Homeland Security determines that a waiver is required “in the interest of homeland security, or to prevent the loss of any jobs in the United States or prevent the Government from incurring any additional costs that it would otherwise not incur.” However, Congress subsequently amended the waiver provisions of the Homeland Security Act in 2003-2004, first by striking the provisions about job loss and additional costs (P.L. 108-7, §101(2)) and later by changing “homeland security” to “national security” (P.L. 108-334, §523). The Homeland Security Act’s waiver provisions, as amended, generally served as a model for later provisions, although Congress in 2005 (P.L. 109-115, §724(b)(2)) added a requirement that agencies waiving the prohibition on contracting with inverted domestic corporations on national security grounds report such waivers to Congress.¹⁶ Subsequent legislation has incorporated this requirement (P.L. 110-161, §745(b)(2); P.L. 111-8, §743(b)(2); P.L. 111-117, §740(b)(2); P.L. 112-74, §738(b)(2); P.L. 113-76, §733(b)(2)).

The FAR provisions implementing the restrictions on contracting with inverted domestic corporations generally reflect the statutory provisions previously discussed. However, while the various statutory provisions state that agencies “shall” waive the prohibition when a waiver is determined to be “required in the interest of national security,” the regulations codified in FAR §9.108-4 provide that the prohibition “may” be waived in such circumstances.

Do the restrictions apply to contracts for commercial items?

The enactments to date do not directly address whether the prohibitions upon contracting with inverted domestic corporations extend to contracts for *commercial items*, or items (other than real property) “of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes.”¹⁷ However, the executive branch has promulgated regulations—codified in FAR §52.212-3(n)—that apply the prohibitions to such contracts.

The Federal Acquisition Streamlining Act (FASA) of 1994 (P.L. 103-355) established a general “preference” for the acquisition of commercial items,¹⁸ and provided that contracts for commercial items are to be exempted from certain generally applicable procurement laws listed in Subpart 12.5 of the FAR.¹⁹ Under FASA, as amended, the Federal Acquisition Regulatory Council (Council) has arguably broad discretion as to which laws to list in Subpart 12.5.²⁰

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Treasury, IRS, *Temporary Regulations, Substantial Business Activities*, 77 Fed. Reg. 34785, 35786 (June 12, 2012).

¹⁶ The various enactments refer to waivers by the agency head. However, nothing would appear to prohibit the agency head from delegating this authority.

¹⁷ 48 C.F.R. §2.101. Certain services are also included within this definition. *See id.*; 41 U.S.C. §103.

¹⁸ 41 U.S.C. §3307.

¹⁹ 41 U.S.C. §1906.

²⁰ 41 U.S.C. §1906(b)(2) (“A provision of law ... that is enacted after October 13, 1994, shall [generally] be included on the list of inapplicable provisions of law ... unless the Council makes a written determination that it would not be in the best interest of the Federal Government to exempt contracts for the procurement of commercial items from the applicability of the provision.”).

However, the council has, to date, opted not to include the prohibitions on contracting with inverted domestic corporations in Subpart 12.5 on the grounds that it is not in the best interest of the federal government to exempt contracts for commercial items from these prohibitions.²¹

Do the restrictions apply to FY2013 or subsequent funds?

The regulations codified in FAR §9.108-2, in particular, seem to have prompted some confusion as to whether the prohibition upon contracting with inverted domestic corporations lapsed with the funds appropriated or otherwise made available by the Consolidated Appropriations Act, 2012 (P.L. 112-74). FAR §9.108-2 expressly references the FY2012 appropriations act, as well as earlier appropriation acts governing FY2006-FY2010 funds. It does not mention any later provisions.

The FAR's silence as to FY2013-FY2015 does not, however, reflect the absence of restrictions as to FY2013-FY2015 funds, but rather the fact that the regulations codified in FAR §9.108-2 have not been updated since May 10, 2012. Thus, they do not reflect subsequent enactments governing the use of FY2013-FY2015 funds. There are a number of such enactments, including provisions in various continuing resolutions that would appear to have extended the prohibitions on contracting with inverted domestic corporations to FY2013 and FY2015 funds by providing, for example, for:

[s]uch amounts as may be necessary, at a rate for operations as provided in the applicable appropriations Acts for fiscal year 2014 and *under the authority and conditions provided in such Acts*, for continuing projects or activities ... that are not otherwise specifically provided for in this joint resolution, that were conducted in fiscal year 2014, and for which appropriations, funds, or other authority were made available in [specified] appropriations Acts.²²

Similarly, language in the “consolidated” appropriations act for FY2014 (P.L. 113-76, §733) expressly bars contracting with inverted domestic corporations in the same way that earlier appropriations acts did.

Do these restrictions constitute debarment?

As reflected by their implementation through regulations in Subpart 9.1 of the FAR (“Responsible Prospective Contractors”), instead of Subpart 9.4 (“Debarment, Suspension, and Ineligibility”), the statutory restrictions on contracting with inverted domestic corporations are effectuated through responsibility determinations, not debarment and suspension (collectively known as “exclusion”). Agencies use both responsibility determinations and exclusion in an effort to avoid *nonresponsible contractors*, or contractors who may be unlikely to perform the contract work on time and in a satisfactory manner.²³ However, responsibility determinations and exclusion involve different processes, and contractors’ rights in these processes also differ.

²¹ Dep’t of Defense, Gen. Servs. Admin., & Nat’l Aeronautics & Space Admin., Prohibition on Contracting with Inverted Domestic Corporations, 74 Fed. Reg. 31561, 31563 (July 1, 2009).

²² See P.L. 113-164, §101 (a) (emphasis added).

²³ See 48 C.F.R. §9.103(c) (“The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this (continued...)”).

A *responsibility determination* is a contract-specific determination as to whether a prospective awardee meets certain criteria prescribed by statute and elaborated upon by regulation (e.g., adequate financial resources; satisfactory record of integrity and business ethics).²⁴ One of these criteria is that the contractor be “otherwise qualified and eligible to receive an award under applicable laws and regulations.”²⁵ This criterion encompasses the so-called “collateral requirements,” or other provisions of law specifying when contractors are disqualified from or ineligible for awards. The prohibitions upon contracting with inverted domestic corporations discussed in this report are such provisions, making them collateral requirements of responsibility.

Agencies generally may not award a contract to a contractor who is non-responsible under the relevant criteria.²⁶ However, determinations as to responsibility are made on a contract-by-contract basis.²⁷ Once an entity can satisfy the criteria—including any collateral requirements—it could be found to be affirmatively responsible. In other words, it is not barred from contracting with the government for any period of time, unlike with exclusion, as discussed below.

Exclusion, in contrast, is imposed for certain causes specified by statute or regulation (e.g., fraud in obtaining or performing a government contract, intentional misuse of the “Made in America” designation),²⁸ and generally lasts for a specified period of time. Specifically, debarments last for a “period commensurate with the seriousness of the cause(s),” generally not exceeding three years, while suspension lasts as long as any agency investigation of the underlying conduct or ensuing legal proceeding.²⁹ Contractors who are excluded are generally barred not only from new contracts (or other purchases) from any government agency, but also from serving as a subcontractor on certain contracts or as an individual surety on a government contract.³⁰

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does not require an award to a supplier solely because that supplier submits the lowest offer. A prospective contractor must affirmatively demonstrate its responsibility, including, when necessary, the responsibility of its proposed subcontractors.”); 48 C.F.R. §9.402(a) (“Agencies shall solicit offers from, award contracts to, and consent to subcontracts with responsible contractors only. Debarment and suspension are discretionary actions that ... are appropriate means to effectuate this policy.”).

²⁴ See generally CRS Report R40633, *Responsibility Determinations Under the Federal Acquisition Regulation: Legal Standards and Procedures*, by Kate M. Manuel.

²⁵ 41 U.S.C. §113(7); 48 C.F.R. §9.104-1(g).

²⁶ See 48 C.F.R. §9.103(b) (“No purchase or award shall be made unless the contracting officer makes an affirmative determination of responsibility.”). It should be noted, however, that responsibility determinations are not required when contracting with (1) foreign, state, or local governments; (2) other U.S. government agencies or their instrumentalities; (3) “agencies for the blind or other severely handicapped” individuals; or (4) prospective contractors outside the United States if application of the responsibility-related criteria would be “inconsistent with the laws or customs where the contractor is located.” 48 C.F.R. §9.102(a)-(b).

²⁷ See 48 C.F.R. §9.103(b).

²⁸ See generally CRS Report RL34753, *Debarment and Suspension of Government Contractors: A Legal Overview*, by Kate M. Manuel.

²⁹ 48 C.F.R. §9.406-4(a)(1) (debarment); 48 C.F.R. §9.407-4(a) (suspension). Debarments are generally limited to one year for violations of the Immigration and Nationality Act, but can last up to five years for violations of the Drug-Free Workplace Act. 48 C.F.R. §9.406-4(a)(1)(i)-(ii). Suspensions may not exceed 18 months unless legal proceedings are initiated within that period. 48 C.F.R. §9.407-4(b).

³⁰ See 48 C.F.R. §9.405(a) & (c). However, any current contracts or subcontracts of debarred or suspended contractors continue unless the agency head directs otherwise. See 48 C.F.R. §9.405-1.

Another important distinction between responsibility determinations and exclusion is that contractors have generally not been seen as entitled to due process, in the form of notice and an opportunity for a hearing, when they are determined nonresponsible,³¹ while they have been found to be entitled to due process when they are excluded.³² However, the legal rationale underlying this distinction—namely, that a determination of nonresponsibility applies only to an individual contract—could potentially be called into question by collateral requirements like those as to inverted domestic corporations. Other collateral requirements arguably either pertain to conduct that is contract-specific (e.g., failure to agree to an acceptable subcontracting plan³³), or that would not serve to effectively bar entities from doing any business with the federal government (e.g., felons prohibited from participating in the contract security guard program of the Federal Protective Service³⁴). The prohibition upon contracting with inverted domestic corporations, in contrast, is neither contract- nor context-specific.

How do agencies ensure they do not contract with inverted domestic corporations?

The statutes prohibiting contracting with inverted domestic corporations do not specify how agencies are to determine whether contractors are inverted domestic corporations. However, the regulations implementing these provisions—codified in FAR §9.108-3—call for contractors to represent that they are not inverted domestic corporations when submitting their bid or offer. Specifically, these regulations require that all solicitations include a standard clause (FAR §52.209-2) which provides that,

By submission of its offer, the offeror represents that—

- (1) [i]t is not an inverted domestic corporation; and
- (2) [i]t is not a subsidiary of an inverted domestic corporation.

FAR §9.108-3(b) further provides that contracting officers may generally rely upon the offeror’s representation that it is not an inverted domestic corporation unless there is “reason to question” the representation. The regulations do not specify what might constitute such a reason. However, the Government Accountability Office (GAO), in the only decision that appears to have addressed this question, found that a competitor’s allegations that the awardee was an inverted domestic corporation did not preclude the award of a new contract to such awardee when the agency had previously investigated the matter and found the awardee was not an inverted domestic corporation.³⁵

³¹ See generally CRS Report R40633, *Responsibility Determinations Under the Federal Acquisition Regulation: Legal Standards and Procedures*, by Kate M. Manuel.

³² See, e.g., *Horne Brothers, Inc. v. Laird*, 463 F.2d 1268, 1271 (D.C. Cir. 1972) (due process in suspension proceedings); *Gonzalez v. Freeman*, 334 F.2d 570 (D.C. Cir. 1964) (due process in debarment proceedings).

³³ 15 U.S.C. §637(d)(4)(C) (plans in negotiated procurements); 15 U.S.C. §637(d)(5)(B) (plans in sealed-bid procurements). See also 48 C.F.R. §22.802(b); Exec. Order No. 11246, 30 Fed. Reg. 12319 (Sept. 24, 1965) (contractors ineligible if they do not comply with certain Equal Employment Opportunity (EEO) requirements imposed on federal contractors); 48 C.F.R. §§9.500-9.507 (barring the award of contracts where there are organizational conflicts of interest that cannot be mitigated or avoided).

³⁴ Federal Protective Service Guard Contracting Reform Act of 2008, P.L. 110-356, §2, 122 Stat. 3996 (Oct. 8, 2008).

³⁵ *Inchcape Shipping Services (Dubai) LLC*, B-409465, B-409465.2 (May 12, 2014).

What if a contractor falsely certifies that it is not an inverted domestic corporation?

The government has a number of potential avenues of recourse if a contractor falsely represents it is not an inverted domestic corporation in its bid or offer, or if it becomes an inverted domestic corporation during the course of performing a contract. Key among these is a standard solicitation and contract clause (FAR §52.209-10), which provides that,

[i]f the contractor reorganizes as an inverted domestic corporation or becomes a subsidiary of an inverted domestic corporation at any time during the period of performance of this contract, the Government may be prohibited from paying for Contractor activities after the date when it becomes an inverted domestic corporation or subsidiary. The Government may seek any available remedies in the event the Contractor fails to perform in accordance with the terms and conditions of the contract as a result of Government action under this clause.

Although not specified here, these “available remedies” could, depending upon the circumstances, include equitable reductions in price or other consideration, reprocurement at the contractor’s expense, and reduction or withholding of award or incentive fees. The contractor could also be subject to termination for default, negative performance evaluations, or debarment or suspension. Monetary damages for fraud are also possible, as discussed in CRS Report R43460, *Contractor Fraud Against the Federal Government: Selected Federal Civil Remedies*, by Brandon J. Murrill.

Proposed Legislation

Other questions and answers pertain to legislation introduced in the second session of the 113th Congress that would either extend the preexisting ban on contracting with inverted domestic corporations (H.R. 3547, H.R. 4870, H.R. 5464, H.R. 5016) or would make this ban permanent and strengthen it (H.R. 5278, S. 2704). This section focuses specifically on those measures that would make this prohibition permanent (i.e., the No Federal Contracts for Corporate Deserters Act of 2014 (H.R. 5278, S. 2704)).³⁶

How do H.R. 5278 and S. 2704 differ from the current provisions?

The restrictions on contracting with inverted domestic corporations contained in H.R. 5278 and S. 2704 differ from earlier restrictions in several ways. Arguably the most significant of these pertains to the definition of *inverted domestic corporations* and, thus, which corporations would be excluded by the prohibition. However, there are also other differences, as noted below.

Definition of Inverted Domestic Corporation

H.R. 5278 and S. 2704 would broaden the definition of *inverted domestic corporation* used for purposes of the contracting prohibitions. As discussed above, one criterion under current law for treating a foreign corporation as an inverted domestic corporation is that the inversion does not

³⁶ The appropriations measures noted here (H.R. 3547, H.R. 4870, H.R. 5464, H.R. 5016) can also be seen as having been removed from active consideration, at least at present, by the enactment of the Continuing Appropriations Resolution, 2015 (P.L. 113-164).

result in a significant ownership change (i.e., after the inversion, at least 80% of the foreign corporation's stock is owned by former shareholders of the U.S. corporation). The bills would expand the definition of *inverted domestic corporation* by making two changes to the 80% ownership threshold. First, they would reduce the 80% threshold to 50%. Second, they would provide an alternative test, so that even if the new 50% ownership threshold was not met, a corporation would still be treated as an inverted domestic corporation if (1) the management and control of the expanded affiliated group occurs primarily within the United States and (2) the group has significant U.S. business activities, which would mean that at least 25% of the expanded affiliated group's employees, employee compensation, assets, or income were in or derived from the United States (with the Treasury Secretary given express authority to reduce the 25% threshold by regulation).

The bills would also address the exception for companies with "substantial business activities" in the foreign country by requiring the Treasury Secretary to issue regulations defining what the term means. The regulations could not treat any expanded affiliated group as having substantial business activities if the group would not be so treated under the existing IRC §7874 regulations. Those regulations require that at least 25% of the group's employees, employee compensation, assets, and income be in or derived from the foreign country.³⁷

Permanence of Restrictions

H.R. 5278 and S. 2704 would amend Titles 10 and 41 of the *United States Code* to bar defense and civilian agencies, respectively, from contracting with inverted domestic corporations at any time (at least until such prohibitions are repealed). In contrast, all earlier enactments, with the exception of the Homeland Security Act of 2002 (P.L. 107-296), apply only to funds appropriated or otherwise made available in particular fiscal years.

Relatedly, the restrictions provided for in H.R. 5278 and S. 2704 would generally apply government-wide (i.e., to all agencies whose procurements are governed by the relevant provisions of Titles 10 and 41 of the *United States Code*). Some earlier enactments, in contrast, applied to specific agencies (e.g., P.L. 107-296, §835).

"Flow Down" to Subcontractors

H.R. 5278 and S. 2704 would expressly provide for the "flow down" of the prohibition on contracting with inverted domestic corporations to first-tier subcontractors. That is, both measures would require that agencies include in each contract valued in excess of \$10 million, other than a contract for "exclusively commercial items,"³⁸ a clause that prohibits the contractor from awarding a first-tier subcontract with a value greater than 10% of the total value of the prime contract to an inverted domestic corporation or a subsidiary thereof (or structuring the subcontract tiers to avoid this restriction).³⁹ The clause would also provide that the contract may be terminated for default, and the contractor referred for debarment or suspension, if the contractor fails to comply, although such recourse would generally be available to the government

³⁷ 26 C.F.R. §1.7874-3T; see also discussion *supra* note 15.

³⁸ See generally "Do the restrictions apply to contracts for commercial items?"

³⁹ There is no express provision for waivers of this clause (e.g., in situations involving national security considerations).

even if the contract did not expressly provide for it.⁴⁰ The current restrictions, in contrast, do not extend to subcontractors.

Reporting Requirements

H.R. 5278 and S. 2704 would give additional direction as to when and to whom agencies must report any waivers. Prior enactments had prescribed that “[a]ny Secretary issuing a waiver ... shall report such issuance to Congress” (e.g., P.L. 113-76, §733(b)(2)). However, the enactments did not require that the reports be submitted within any specific time after the waiver’s issuance, or to any specific committees of Congress. The proposed legislation would change this by directing that reports be submitted within 14 days of the waiver’s issuance to the “relevant authorizing committees” of the agency issuing the waiver.

Other

H.R. 5278 and S. 2704 also refer to entities that the agency “head has determined” are inverted domestic corporations. This language could be construed as requiring agencies to make their own determinations as to whether contractors are inverted domestic corporations, rather than relying upon contractors’ representations, as has historically been done (see “How do agencies ensure they do not contract with inverted domestic corporations?”). On the other hand, given that the measures would not expressly require that agencies make their own independent determinations, nothing would appear to preclude the executive branch from adopting the view that agencies may generally rely upon contractors’ representations in making agency determinations.

To what types of contracts does the proposed legislation apply?

H.R. 5278 and S. 2704 would generally bar executive agencies from awarding “contracts” to inverted domestic corporations, but neither defines what is meant by *contract*. Earlier enactments also used the terms *contract* or *federal government contract* without defining these terms (e.g., P.L. 109-115, §724(a); P.L. 107-296, §835(a)). However, these measures appear to have been implemented primarily, if not exclusively, through regulations in the FAR and agency FAR supplements.⁴¹ These regulations apply only to what the Federal Grant and Cooperative Agreement Act (P.L. 95-224) defines as *procurement contracts*, or contracts “the principal purpose of [which] is to acquire (by lease, purchase, or barter) property or services for the direct benefit or use of the United States government.”⁴² Thus, the prohibitions on contracting with inverted domestic corporations have, to date, not been extended to concession contracts (e.g., contracts whereby a vendor pays the agency for the right to operate a facility and charge fees to third-parties using the facility); contracts awarded by state or local governments, or other entities, pursuant to federal grants or cooperative agreements; or contracts whereby the federal government reimburses entities for services or supplies provided to beneficiaries of federal programs.

⁴⁰ See generally CRS general distribution memorandum, Potential “Remedies” Available to the Government for a Contractor’s Misconduct or Failure to Perform, by Kate M. Manuel, February 11, 2010 (copy available upon request).

⁴¹ For further discussion of the FAR and FAR supplements, see *supra* note 12.

⁴² 31 U.S.C. §6303.

Given this history, and the absence of a definition of the term *contract* in H.R. 5278 and S. 2704, it seems likely that the term *contract* would be construed in the same way, particularly since these measures would amend provisions in Titles 10 and 41 of the *United States Code* that generally govern procurement contracts. On the other hand, the word *contract* could be construed more broadly to encompass any agreement, and there have been calls for the restrictions on contracting with inverted domestic corporations to be extended to at least some nonprocurement contracts.⁴³

Would these restrictions apply to existing contracts, or orders under existing contracts?

Both H.R. 5278 and S. 2704 provide that their restrictions, if adopted, “shall not apply to any contract entered into before the date of [their] enactment.” However, both seek to impose these restrictions on any task or delivery order issued after their enactment, regardless of whether the contract under which the order was issued was formed before, on, or after the date of enactment.

In exempting existing contracts from their restrictions, the proposed legislation is not only consistent with earlier statutes (e.g., P.L. 110-161, §745(c); P.L. 111-8, §743(c)), but also avoids concerns about breach of contract. Such a breach could arise if the government, as a party to the contract, enacted legislation that purported to impose a requirement upon the other party which the parties had not agreed to at the time when the contract was formed. This is because the parties to a contract are generally bound by the terms of their agreements, and may not impose additional requirements upon one another without mutual agreement and consideration (i.e., something of value promised in return).⁴⁴

The proviso that the requirements would apply to any task or delivery orders under existing contracts issued after the legislation’s enactment, in contrast, is an express departure from earlier statutes, which had exempted both existing contracts *and* new orders under existing contracts from their requirements (e.g., P.L. 110-161, §745(c); P.L. 111-8, §743(c)). The inclusion of new orders under existing contracts would appear to be intended to address what some commentators have characterized as a “loophole” in earlier enactments that permits inverted domestic corporations to receive task and delivery orders under contracts awarded years ago (either before the ban, or before they were inverted domestic corporations).⁴⁵ However, questions could be raised as to whether subjecting certain task and delivery orders—particularly orders under indefinite delivery contracts, or orders required to meet the guaranteed minimum order under indefinite delivery/indefinite quantity (ID/IQ) contracts⁴⁶—to conditions that were not included in the underlying contract constitutes breach of contract, as previously discussed.

⁴³ See, e.g., Dietrich Knauth, *Congresswoman Demands Military End Burger King Contracts*, LAW 360, Oct. 1, 2014.

⁴⁴ See, e.g., *Ford v. Ford*, 68 P.3d 1258, 1268 (Alaska 2003).

⁴⁵ See, e.g., How to Win Billions in Federal Contracts on a Permanent Tax Holiday, *supra* note 1.

⁴⁶ *Indefinite-delivery contracts* provide for the contractor to deliver supplies or services to the government at future dates unspecified at the time of contracting. *ID/IQ contracts* are a type of indefinite-delivery contract that provides for the contractor to deliver a generally unspecified quantity of supplies or services to the government at unspecified future dates. An ID/IQ contract does not entitle the contractor to fill all the agency’s requirements for specified supplies or services. However, the contractor is entitled to orders for a “minimum quantity” of supplies or services specified in the contract. See 48 C.F.R. §16.504(a)(1) (“The contract must require the Government to order and the contractor to furnish at least a stated minimum quantity of supplies or services.”).

Could the President bar contracting with inverted domestic corporations without congressional action?

In an August 13, 2014, letter to President Obama, several Members of Congress urged that he use his “executive authority, to the maximum extent possible, to deny federal contracts” to inverted domestic corporations.⁴⁷ This letter does not cite any specific authority for such presidential action. However, Sections 201 and 205(a) of the Federal Property and Administrative Services Act (FPASA) of 1949 (P.L. 81-152, codified, as amended, at 40 U.S.C. §§101 & 121) have generally been construed to grant the President broad authority to impose requirements that promote “economy” and “efficiency” in procurement.⁴⁸ Presidents have, for example, relied on their authority under FPASA to bar federal contractors from discriminating on the basis of race, creed, color, or national origin (Executive Order 8802, June 25, 1941), and to require them to take affirmative action to ensure that job applicants are employed, and employees are treated during employment, without regard to race, color, religion, sex, or national origin (Executive Order 11246, October 12, 1965, as amended).⁴⁹ Sections 201 and 205(a) of FPASA could similarly serve as the basis for executive action to restrict contracting with inverted domestic corporations.

A few actions have, however, been found to have been outside the President’s authority under FPASA, either because their link to economy and efficiency in procurement was too attenuated,⁵⁰ or because they were specifically barred by a federal statute.⁵¹ Here, at least one commentator has suggested that executive action barring agencies from contracting with inverted domestic corporations could perhaps be said to be barred by the Competition in Contracting Act (CICA, P.L. 98-369) of 1984, as amended.⁵² CICA generally requires agencies to “obtain full and open competition through the use of competitive procedures,”⁵³ and defines *full and open competition* to mean that “all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement.”⁵⁴ Thus, an argument could be made that barring agencies from awarding

⁴⁷ A copy of this letter is available at <http://www.reed.senate.gov/download/letter-to-president-obama-urging-action-on-inverted-corporations>.

⁴⁸ Section 205(a) of FPASA, in particular, authorizes the President to prescribe any “policies and directives” that he “considers necessary to carry out” the act, while Section 201 establishes that FPASA’s purpose is to provide the federal government with an “economical and efficient system ... for [p]rocur[ing] and supply[ing] property and nonpersonal services.”

⁴⁹ For further discussion of the President’s authority to impose requirements on the procurement process, see CRS Legal Sidebar WSLG805, *What Is the Source of the President’s Authority to Regulate the Procurement Process?*, by Kate M. Manuel and CRS Legal Sidebar WSLG806, *What Limits Are There on the President’s Authority to Regulate the Procurement Process?*, by Kate M. Manuel.

⁵⁰ See *Liberty Mutual Insurance Co. v. Friedman*, 639 F.2d 164, 166 (4th Cir. 1981) (striking down a Department of Labor determination that firms that underwrite workers’ compensation policies for federal contractors are subject to the antidiscrimination and affirmative action requirements generally imposed on federal contractors because it viewed the requirement as too far removed from what Congress had in mind when it authorized the President to issue “policies and directives” promoting economy and efficiency in procurement).

⁵¹ See *Chamber of Commerce of the United States v. Reich*, 74 F.3d 1322, 1339 (D.C. Cir. 1996) (finding that an executive order directing the Secretary of Labor to promulgate regulations providing for the debarment of contractors who hired permanent replacements for striking workers was invalid because the National Labor Relations Act (NLRA) “preserved to employers the right to permanently replace economic strikers as an offset to the employees’ right to strike,” and the executive order conflicted with the NLRA).

⁵² See David Hansen, *Corporate Inversion Executive Order Possible, Crowell Partner Advises Contractors*, 102 FED. CONT. REP. 311 (Sept. 16, 2014).

⁵³ 10 U.S.C. §2304(a)(1)(A) (procurements of defense agencies); 41 U.S.C. §3301(a)(1) (procurements of civilian agencies).

⁵⁴ 41 U.S.C. §107.

contracts to inverted domestic corporations runs afoul of CICA by effectively excluding these sources from the competition. On the other hand, federal law defines a *responsible source* as one that is, among other things, “qualified and eligible to receive an award under applicable laws and regulations.”⁵⁵ Thus, an argument could also be made that, if the President barred the award of contracts to inverted domestic corporations, such corporations would not be responsible sources because they would no longer be eligible for award under applicable regulations (i.e., the regulations promulgated to implement the executive action).

Relationship to Other Restrictions

Yet other questions concern the relationship between the current or proposed restrictions on contracting with inverted domestic corporations and other provisions of federal law that (1) generally require federal agencies to purchase “domestic” items, and (2) expressly or effectively preclude some or all foreign corporations from performing certain contracts.

Does the Buy American Act bar dealings with inverted domestic corporations?

The Buy American Act generally would not bar federal agencies from purchasing supplies or construction materials from foreign persons—including inverted domestic corporations—so long as the supplies or construction materials are mined, produced, or manufactured in the United States, as required by the act. Where it applies,⁵⁶ the Buy American Act generally requires that any “end products” or “construction” materials be mined or produced in the United States, in the case of *unmanufactured items*; or manufactured in the United States “substantially all” from items mined, produced, or manufactured in the United States, in the case of *manufactured items*.⁵⁷ The regulations implementing the Buy American Act further provide that items are manufactured “substantially all” from items mined, produced, or manufactured in the United States if either (1) at least 50% of the costs of their components are mined, produced, or manufactured in the United States, or (2) the item is a commercially available off-the-shelf (COTS) item.⁵⁸ End products or construction materials that satisfy the act’s requirements qualify as “domestic,” regardless of the offeror’s nationality.⁵⁹ Purchases of services are generally not subject to the Buy American Act.⁶⁰

⁵⁵ 41 U.S.C. §113(7); 48 C.F.R. §9.104-1(g).

⁵⁶ The Buy American Act does not apply to procurements that are subject to other domestic content requirements, such as the so-called Berry Amendment or specialty metals restriction. See CRS Report R43354, *Domestic Content Restrictions: The Buy American Act and Complementary Provisions of Federal Law*, by Kate M. Manuel et al. The application of the Buy American Act application may also be waived, pursuant to the Trade Agreements Act, in many procurements whose anticipated value exceeds \$204,000 (\$7,864,000 for construction contracts). See generally 48 C.F.R. Subpart 25.4.

⁵⁷ 41 U.S.C. §8302 (purchases of supplies); 41 U.S.C. §8303 (construction of public works). For more on what constitutes an *end product* or *construction materials* for purposes of the Buy American Act, see generally CRS Report R43140, *The Buy American Act—Preferences for “Domestic” Supplies: In Brief*, by Kate M. Manuel.

⁵⁸ See 48 C.F.R. §25.003.

⁵⁹ See, e.g., Military Optics, Inc., B-245010.3; B-245010.4 (Jan. 16., 1992) (“The fact that the manufacturer of a domestically manufactured end product may be foreign owned is not a factor to be considered in determining whether to apply the Buy American Act differential.”).

⁶⁰ See, e.g., Bell Helicopter Textron, B-195268 (Dec. 21, 1979); Blodgett Key punching Co., B-153751 (Oct. 14, 1976). However, any “supply” portions of a service contract could potentially be subject to the Buy American Act.

What about other restrictions on contracting with foreign corporations?

Foreign corporations—or corporations that are not incorporated or legally organized within the United States—are not *per se* excluded from contracting with the U.S. government. There are certain provisions of federal law that expressly or effectively preclude some or all foreign corporations from performing specific contracts. For example, Section 836(a)(1) of the National Defense Authorization Act for FY1993 (P.L. 102-484, codified at 10 U.S.C. §2536) prohibits the Departments of Defense and Energy from awarding contracts under a “national security program” to entities “controlled” by foreign governments if that entity would need to be given access to a “prescribed category of information” (e.g., special access information) in order to perform the contract. Similarly, Sections 402 and 406(c) of the Omnibus Diplomatic Security and Antiterrorism Act of 1986 (P.L. 99-399, codified in 22 U.S.C. §4852) limit certain construction projects abroad to “U.S. persons” or “U.S. joint venture persons,” and exclude entities that have “business arrangements” with Libya.⁶¹ However, as these examples illustrate, restrictions on contracting with foreign corporations are not synonymous with the current or proposed restrictions on contracting with inverted domestic corporations.

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⁶¹ See also 48 C.F.R. §652.236-72.