

# TJAGSA Practice Notes

Faculty, The Judge Advocate General's School

## Tax Law Note

### Update for 1999 Federal Income Tax Returns

In the summer of 1999, Congress passed a massive package of tax changes. However, President Clinton vetoed the legislation. Despite the lack of a comprehensive tax package for 1999, several changes took effect for tax year 1999. The following article is a brief update of current tax issues and includes information that is important for taxpayers in the military community. This article is not intended to serve as an in-depth review or explanation of each topic discussed, rather its intent is to inform legal assistance attorneys of updates in numerology and new tax changes for the upcoming tax season.

#### Key Changes for 1999

##### Child Tax Credit

In 1998, taxpayers were able to claim a child tax credit of \$400 for each "qualifying child"<sup>1</sup> that was under the age of seventeen.<sup>2</sup> In 1999, the child tax credit increases to \$500 for each child under seventeen. The amount of the child tax credit is subject to limitations based upon the taxpayers modified adjusted gross income (MAGI).<sup>3</sup> For most taxpayers, the credit is nonrefundable and is subject to other limitations based upon tax liabilities.<sup>4</sup> However, an additional child tax credit applies to families with three or more qualifying children.<sup>5</sup> Families with three or more qualifying children may be able to take the credit as a refundable tax credit.<sup>6</sup>

ried filing separately phase out limitations are \$0 - \$10,000;

Last year, the child tax credit had a tremendous impact on military taxpayers with children under seventeen by increasing the size of tax refunds and decreasing overall taxes. Many military taxpayers that did not adjust their federal income tax withholding in 1998 saw their overall tax liability decrease or the size of refunds increase. Military taxpayers that received a large refund due to the child tax credit should consider a corresponding reduction in wage withholding.

##### Student Loan Interest Deduction

In 1998, for the first time, taxpayers legally obligated to pay student or educational loans could take an above-the-line deduction or adjustment to income for the interest paid on these loans.<sup>7</sup> In 1998, this above-the-line deduction was capped at \$1000.<sup>8</sup> In 1999, the maximum deduction increases to \$1500 of interest per year. Although most personal interest is non-deductible for federal income tax purposes, the student loan interest deduction is an adjustment to income, and the taxpayer does not have to itemize to take the deduction.

##### Individual Retirement Arrangements (IRAs)

More service members will be eligible to take a deduction for traditional IRAs in 1999 due to an increase in the phase out limitations. Because service members are active participants in a retirement plan, deductible IRA contributions are subject to limitations.<sup>9</sup> For 1999, taxpayers who are married and filing a joint return are subject to phase-out limitation if their AGI exceeds \$51,000 and eliminated if AGI exceeds \$61,000 (marriage phase out for singles is \$31,000 to \$41,000).<sup>10</sup>

1. A "qualifying child" is a son, daughter, stepchild, eligible foster child, or other descendant for whom the taxpayer can claim a dependency deduction for the tax year. The "qualifying child" must also be a citizen or resident of the United States. I.R.C. § 24(c) (West 1999).

2. *Id.* § 24.

3. For joint taxpayers, the credit will be reduced by \$50 for every \$1000 of adjusted gross income (AGI) above \$110,000. Likewise, it will be reduced in a similar manner for unmarried individuals with AGI above \$75,000 and those taxpayers that are married filing separately with an AGI in excess of \$55,000. *Id.* § 24(b).

4. *Id.* § 26.

5. The additional credit is computed by adding the taxpayer's social security taxes paid for the tax year to the tax liability limitations of I.R.C. § 26, and subtracting that amount by all nonrefundable credits, the earned income credit (not including the supplemental child credit as specified in I.R.C. § 32(n)). *Id.* § 24(d).

6. *Id.* § 24(d).

7. The deduction is limited to interest paid during the first 60 months in which payments are required. *Id.* § 221.

8. *Id.* § 221(d)(1).

9. *Id.* § 219(g)(1); I.R.S. Notice 87-16; Morales-Caban v. Commissioner, T.C. Memo 1993-466, 66 T.C.M. (CCH) 995 (1993).

10. *Id.* § 219(g).

*No Legislative Relief for Military Taxpayers on the Sale of a Home*

For principal residences sold after May 1997, a single taxpayer may exclude up to \$250,000 of gain, and married taxpayers that file jointly may exclude up to \$500,000.<sup>11</sup> To qualify for excluding the gain, the taxpayer must have owned and used the property as a principal residence for two or more years during the five year period ending on the date of sale.<sup>12</sup> The changes in the Internal Revenue Code in 1997 repealed the old "roll over" rules that allowed homeowners to defer the gain from the sale of a principal residence by purchasing a new home of equal or greater value.<sup>13</sup> An abundance of case law developed under the old roll over provisions allowed a homeowner to be absent from his principal residence for extended periods of time without the home losing the status as the principal residence. In addition, the repealed roll over provisions provided military taxpayers with as much as eight years after the sale of a principal residence to purchase a new residence and roll the gain into the new home to defer the tax.<sup>14</sup>

The new Internal Revenue Code provision regarding the sale of principal residence for homes sold after May 1997 means that a taxpayer must actually "own and use" the home for two years out of the last five years immediately preceding the sale to qualify the property for a complete tax exclusion.<sup>15</sup> This rule is strictly applied under the tax code, and the prior facts and circumstances test of the old roll over rules no longer applies. The new exclusion of gain provisions is a tremendous tax benefit for the majority of homeowners. However, applying the provisions to military taxpayers results in the failure of homeowners that are assigned away from the home to meet the "own and use" test of the new provisions. Many military taxpayers absent from their homes for extended periods of time assumed they could roll over the gain upon the sale of the home. For sales after May 1997, the assumption may no longer be applicable. Under current tax laws, there is no special relief for service members absent from their home due to military service. During 1998 and 1999, there were numerous legislative attempts to

provide specific relief for military homeowners away from their home due to military service. As of the date of publication, none of the legislation has been enacted into public law. Therefore, the military taxpayer must read and apply a literal interpretation of the current provisions of the tax code regarding the use and ownership of a principal residence. The Armed Forces Tax Council is continuing to pursue relief for service members.

*1999 Tax Year in Review*

*Service Members Assigned to NATO May Not Elect Foreign Earned Income Exclusion for Military Compensation*

The Internal Revenue Service (IRS) issued a technical assistance memorandum<sup>16</sup> addressing whether military personnel assigned to the North Atlantic Treaty Organization (NATO) are eligible to exclude from gross income the compensation earned during assignment to NATO under the foreign earned income exclusion.<sup>17</sup> Generally, the foreign earned income exclusion provides that gross income earned from sources within a foreign country may be excluded up to a specified amount.<sup>18</sup>

In distinguishing service members from other types of employees, the IRS noted that service members assigned to NATO are still members of the United States military. Because the federal government provides service members with benefits, pays the salaries of service members, maintains authority to hire, fire, and discipline service members while assigned to NATO, then service members remain employees of the United States government. The IRS cited and distinguished *Adair v. Commissioner*,<sup>19</sup> and concluded that service members are employees of the United States, and are not allowed to take the foreign earned income exclusion for military compensation while assigned to NATO.

11. *Id.* § 121.

12. *Id.*

13. *Id.* § 1034 (repealed 1997).

14. *Id.* § 1034 (h) (repealed 1997).

15. *Id.* § 121.

16. Memorandum, Chief, Branch 2, Employee Benefits and Exempt Organizations, subject: Computation of Excluded Military Retired Pay Under Internal Revenue Code § 122 (31 Mar. 1999) in TAX NOTES TODAY (June 1999) available at LEXIS 1999-TNT 104-64 [hereinafter Employee Benefits Memorandum].

17. I.R.C. § 911.

18. For 1999, the exclusion is \$74,000; 2000 it will be \$76,000; 2001 it will be \$78,000,00; and 2002 and years thereafter will be \$80,000. *Id.* § 911(b).

19. 70 T.C.M. (CCH 998) (1995), *acq.*, 1996-1 C.B.1.

*Income Tax Exclusion of VA Disability Benefits vs. Inclusion of Military Retirement Pay*

In 1999, the IRS reiterated that military retirement pensions based upon number of years of service, and not disability, are not excludable from gross income.<sup>20</sup> Likewise, in a similar case, the United States Tax Court held that a retired officer was not entitled to exclude any portion of his military service retirement pension from taxable income even though the Veterans Administration (VA) gave the retiree a disability rating after he retired.<sup>21</sup>

In both of these cases, the retiree received military retirement pay based on years of service. The retirees had not retired due to disabilities, but applied for disability benefits after retirement. Following retirement, the VA made determinations that the retirees had disabilities. Based upon the percentage disability determined by the VA, the retirees elected to waive years of service retirement benefits to the extent of VA benefits so that they could receive the VA benefits tax-free. However, in both of these cases the retirees went on to reduce their military retirement by a disability exclusion ratio. The retirees made the reduction to their retirement pay after the Defense Finance and Accounting Service (DFAS) reduced retirement pay by the amount waived to receive the VA benefit. Because the taxpayers were retired for years of service and not for disability, the retirees could not exclude the amount calculated as disability exclusion.<sup>22</sup> The retirement pay was not received for personal injury or sickness, and was not excludable. The retirees already had their taxable retired pay reduced by the amount of VA benefits, and were not entitled to a second exclusion because of the same disability. The DFAS had properly reported the taxable amount of the retirement benefits, on Form 1099-R, and did not include the VA disability benefits.

A VA disability determination does not convert a military service retirement into a disability pension. The retiree has the burden of proving that pension payments that are received for a disability are incurred during active service in the military.<sup>23</sup> Otherwise, there is a presumption that retirement pay for length of service will not be exempt from federal income taxation.

---

20. Employee Benefits Memorandum, *supra* note 16.

21. Holt v. Commissioner, No. 187-98 T.C.M. (CCH) 1999-348 (1999).

22. I.R.C. § 104(a)(4).

23. Scarce v. Commissioner, 17 T.C. 830, 833 (1951).

24. I.R.C. § 32.

25. 43 Fed. Cl. 659 (1999).

26. 37 U.S.C.A. § 101(2) 1999).

27. I.R.C. § 32(c)(2)(A)(i).

28. Uruguay Round Agreements Act, Pub. L. No. 103-465 § 721, 108 Stat. 4809 (1994) (adding subparagraph 10 to I.R.C. § 6051(a); . H.R. REP. NO. 103-826, pt. 1, at 180-81 (1994).

*Quarters and Subsistence Allowances Are “Earned Income” for Purposes of the Earned Income Tax Credit*

Judge advocates have long preached the gospel that for purposes of computing the Earned Income Tax Credit (EITC)<sup>24</sup> service members must include (in the calculation) the amount of military quarters and subsistence allowances received in payment or in-kind during a tax year. Nevertheless, in *Neff v. United States*,<sup>25</sup> a service member filed an amended tax return in 1997 claiming an EITC. In the amended return, the military taxpayer did not include the amount of military quarters and subsistence allowances in the EITC calculation. However, the military taxpayer did include a lengthy, hand written letter of explanation attached to the amended return arguing that quarters and subsistence allowances should not be considered earned income. The IRS disallowed the claim for EITC in the amended return, and the military taxpayer filed a complaint in the Court of Federal Claims. Summary judgment was granted for the government, but the court included a very detailed analysis of the EITC as it relates to military taxpayers (specifically addressing quarters and subsistence allowances).

The court closely examined the statutory basis and legislative history of the EITC. The service member contended that quarters and subsistence allowances are not compensation for purposes of EITC. However, the court held that Congress intended “regular compensation” or “regular military compensation” to include not only basic pay, but also basic allowance for quarters (including variable housing allowance or station housing allowance), and basic allowance for subsistence.<sup>26</sup> The court went on to indicate that because “compensation” constitutes earned income under the EITC,<sup>27</sup> the value of quarters and subsistence allowances must be included in earned income. The court analyzed the legislative history of military pay, allowances, and the EITC.<sup>28</sup> In deciding what constitutes “earned income” under the EITC, the Court of Federal Claims noted that the Tax Court has also held that quarters and subsistence allowances are earned income.<sup>29</sup>

Legal assistance attorneys and tax center personnel are often challenged by military taxpayers regarding the inclusion of

quarters and subsistence allowances in the calculation of EITC during tax preparation. *Neff* provides a clear explanation and authority to military taxpayers as to the legal basis for the inclu-

sion of these “nontaxable” allowances in the calculation of the EITC.

29. *Jones v. Commissioner of Internal Revenue Service*, 66 T.C.M. (CCH) 368, 370 (1993).

## 1999 Numerology

### Tax Rates

The 1999 tax rates are: 15%, 28%, 31%, 36%, and 39.6%. The 1999 tax rates by filing status are:

#### Married Filing Jointly and Surviving Spouses:

<u>Taxable Income</u>	<u>Marginal Tax Rate</u>
\$1 - 43,050	15%
43,050 - 104,050	28%
104,050 - 158,550	31%
158,550 - 283,150	36%
over 283,150	39.6%

#### Single

<u>Taxable Income</u>	<u>Marginal Tax Rate</u>
\$1 - 25,750	15%
25,750 - 62,450	28%
62,450 - 130,250	31%
130,250 - 283,150	36%
over 283,150	39.6%

#### Head of Household:

<u>Taxable Income</u>	<u>Marginal Tax Rate</u>
\$0 - 34,500	15%
34,500 - 89,150	28%
89,150 - 144,400	31%
144,400 - 283,150	36%
over 283,150	39.6%

#### Married Filing Separately:

<u>Taxable Income</u>	<u>Marginal Tax Rate</u>
\$1 - 21,525	15%
21,525 - 52,025	28%
52,025 - 79,275	31%
79,275 - 141,575	36%
over 141,575	39.6%

**Standard Deduction:**

Married Filing Jointly or Qualifying Widow(er) – 1999: \$7200 (\$7100 in 1998; \$7350 projected for 2000).

Single – 1999: \$4300 (\$4250 in 1998; \$4400 projected for 2000).

Head of Household – 1999: \$6350 (\$6250 in 1998; \$6450 projected for 2000).

Married Filing Separately – 1999: \$3600 (\$3550 in 1998; \$3675 projected for 2000).

**Reduction of Itemized Deductions**

Otherwise allowable itemized deductions are reduced if AGI in 1999 exceeds:

Married Filing Separately - \$63,300 (projected at \$64,475 for 2000).

All other returns - \$126,600 (projected at \$128,950 for 2000).

**Personal Exemptions**

Personal exemption deduction - \$2750 (\$2700 in 1998).

Phase Out of Personal Exemptions:

<u>Taxpayer</u>	<u>Begins After</u>
Married Filing Jointly	15%
Single	28%
Head of Household	31%
Married Filing Separately	36%
over 283,150	39.6%

Major Rousseau.

***Legal Assistance Note***

**Involuntary Allotments: Another Weapon in the Family Support Arsenal**

A legal assistance client comes to you with a support order in hand and says that he has not received child support payments from his soldier spouse for several months. *Army Regulation (AR) 608-99* requires soldiers to comply with the financial support provisions of all court orders,<sup>30</sup> and allows commanders to punish a soldier who falls into

arrears.<sup>31</sup> However, there is currently no mechanism in place to allow commanders to force their soldiers to pay arrears.<sup>32</sup> What do you do?

Involuntary allotments are an effective method of collecting child and spousal support from soldiers who lag behind in their support obligations. Questions arise concerning when an involuntary allotment can be initiated against a soldier.

Two prerequisites must be met before initiating an involuntary allotment. First, there must be an order of child support.<sup>33</sup> Second, there must be arrears.<sup>34</sup> The order for support can

30. U.S. DEP'T OF ARMY, REG. 608-99, FAMILY SUPPORT, CHILD CUSTODY, AND PATERNITY, para. 2-4a (1 Nov. 1994).

31. Paragraph 2-5(c) of *AR 608-99* states in part that “[p]unishment in such instances is based on the failure to provide financial support when due, not for failure to pay arrears.” *Id.*

32. *Id.* “Although the collection of arrearsages . . . may be enforced in court, there is no legal means for the military to enforce collection of arrearsages . . . .”

33. 42 U.S.C.A. § 665(a)(1) (West 1999).

be from either a court or an administrative agency,<sup>35</sup> and must be for either child support alone or for child support and spousal support.<sup>36</sup> The amount of arrearages must equal or exceed the amount of support required over a two-month period.<sup>37</sup> This requirement sometimes causes confusion. Separated and former spouses often want an involuntary allotment initiated if their monthly support check is less than the ordered amount for two consecutive months. Under 42 U.S.C.A. Section 665 (a)(1), the arrearages must *total* at least two months support, not underpayments in two consecutive months.<sup>38</sup> For example, if a family member receives \$400 a month in child support instead of the required \$500 a month, the total amount of arrears must equal at least two months' support, or \$1000.

Once those prerequisites have been satisfied, an "authorized person,"<sup>39</sup> usually a state child enforcement agency representative or court clerk, sends the request for an involuntary allot-

ment to the Defense Finance and Accounting Service (DFAS).<sup>40</sup> The DFAS notifies the soldier involved and his commander of the proposed action.<sup>41</sup> Barring an appropriate and timely response from the soldier,<sup>42</sup> the involuntary allotment begins.

Soldiers also mistakenly believe that they can stop an involuntary allotment once they are no longer in arrears. This is not the case. Under the statute, an involuntary allotment remains in effect until the "authorized person" asks that it be stopped.<sup>43</sup>

Involuntary allotments are a valuable tool in ensuring that soldiers meet their support obligation. Legal assistance attorneys should know the requirements to initiate one, as well as the possible defenses to such an initiation. Major Boehman.

---

34. *Id.*

35. 32 C.F.R. pt. 54.3(f) (1999). This regulation defines support order as:

Any order providing for child or child and spousal support issued by a Court of competent jurisdiction within any State, territory, or possession of the United States, including Indian tribal courts, or in accordance with administrative procedures established under State law that affords substantial due process and is subject to judicial review.

*Id.*

36. *Id.*

37. 42 U.S.C.A. § 665(a)(1).

38. *Id.* The statute states, in relevant part, that "the resulting delinquency in such payments is in a total amount equal to the support payable for two months or longer."

39. *Id.* § 665(b). An "authorized person" is defined as:

[A]ny agent or attorney of a State having in effect a plan approved under this part who has the duty or authority under such plan to seek to recover any amounts owed by such member as child or child and spousal support (including, when authorized under the State plan, any official of a political subdivision); and (2) the court which has authority to issue an order against such member for the support and maintenance of a child, or any agent of such court.

*Id.*

40. Although this note focuses on Army personnel, similar procedures exist for initiating an involuntary allotment against members of any service. The official from each military service designated to accept service of the request for an involuntary allotment is listed in 32 C.F.R. pt. 54.6(f). For the Army, the designated official is the Commander, U.S. Army Finance and Accounting Center, ATTN: FINCL-G, Indianapolis, Indiana, 46249-0160, telephone (317) 542-2155. The Navy's designated official for service is the Director, Navy Family Allowance Activity, Anthony J. Celebrezze Federal Building, Cleveland, Ohio, 44199, telephone (216) 522-5301. The Air Force's designated official for service is the Commander, Air Force Accounting and Finance Center, ATTN: JA, Denver, Colorado, 80279, telephone (303) 370-7524. The Marine Corps' designated official for service is the Commanding Officer, Marine Corps Finance Center (Code AA), Kansas City, Missouri, 64197, telephone (816) 926-7103.

41. See 32 C.F.R. pt. 54.6 (d)(1). The DFAS serves the service member with written notice that a request for involuntary allotment has been received, along with a copy of all documents received, information about the maximum amount subject to allotment, and notice that the service member can submit affidavits or other evidence on his behalf to show that the information contained in the notice is incorrect.

42. *Id.* The service member has 30 days to from date of notice to submit substantial proof of error, such as that the support payments are not delinquent, or that the underlying support order has been amended, superseded, or set aside.

43. The "authorized person" or the person receiving the allotment must notify the designated official promptly if the court order that gave rise to the allotment is vacated, modified, or set aside. See 32 C.F.R. pt. 54.6 (e)(5).

## *Contract and Fiscal Law Note*

### **A-76 Cost Studies and Conflicts of Interest: The General Accounting Office and the Office of Government Ethics Square Off**

Picture it: You are the legal advisor to a steering group responsible for the cost comparison study of installation support services, conducted under the procedures in Office of Management and Budget (OMB) Circular A-76.<sup>44</sup> You find yourself offering advice regularly on diverse issues in contract law, labor law, and standards of conduct. One day, the contracting officer approaches you with news that the technical team, which will evaluate proposals from private sector offerors, includes members whose jobs are on the line. Under these circumstances, may these team members evaluate the proposals fairly and impartially? Should they evaluate the proposals at all? For guidance, you turn to two key sources: the General Accounting Office (GAO) and the Office of Government Ethics (OGE). You discover, however, that each has rendered a different answer to the question you face.

#### **The GAO Approach: Protecting the Integrity of the Procurement Process.**

During 1999, the GAO issued several opinions analyzing the Department of Defense's cost studies under OMB Circular A-76.<sup>45</sup> In one decision, the GAO highlighted how a conflict of interest, which affects the integrity of the procurement process, can bring a cost study to a screeching halt. In *DZS/Baker LLC*,<sup>46</sup> the GAO sustained a protest filed by two offerors in connection with an Air Force OMB Circular A-76 cost study. The Air Force issued a solicitation for civil operations and maintenance services at Wright-Patterson Air Force Base, Ohio, opt-

ing to use the two-step sealed bid procurement method for the cost study.<sup>47</sup> The solicitation required private offerors to submit initial technical proposals to perform maintenance, operation, repair, and minor construction services for facilities, utilities, and infrastructure at the installation. The Air Force then would issue an invitation for bid to offerors submitting acceptable technical proposals.

Both DZS/Baker and Morrison Knudsen submitted proposals. After advising offerors of the initial evaluation results, the Air Force requested revised technical proposals. The technical team evaluating the revised proposals, however, found them unacceptable. As a result, the Air Force cancelled the solicitation and continued in-house performance of the services.<sup>48</sup> DZS/Baker and Morrison Knudsen protested the Air Force's decision, arguing that fourteen of the sixteen agency evaluators who reviewed the technical proposals held positions that would have been contracted out under the solicitation.<sup>49</sup>

The GAO agreed, finding the evaluation process "fundamentally flawed as a result of a conflict of interest."<sup>50</sup> In its decision, the GAO focused on various Federal Acquisition Regulation (FAR) provisions dealing with conflicts of interest. It cited FAR 3.101-1, which enunciates the "impeccable standard of conduct" that applies to government business and requires agency employees to avoid even the appearance of a conflict of interest:

Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with preferential treatment for none. Transactions relating to the expenditure of public funds require the highest

44. FEDERAL OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-76, PERFORMANCE OF COMMERCIAL ACTIVITIES (Aug. 4, 1983) [hereinafter OMB Circular A-76]. The OMB Circular A-76 describes the executive branch policy and procedures for determining whether contractors or government employees should perform commercial activities.

45. See, e.g., RTS Travel Serv., B-283055, 1999 U.S. Comp. Gen. LEXIS 162 (Sept. 23, 1999) (finding the agency adjusted properly the contractor's price for contract administration costs to reflect the addition of a full-time equivalent quality assurance evaluator); BMAR & Assocs., B-281664, Mar. 18, 1999, 99-1 CPD ¶ 62 (finding that requirement to submit a lump sum bid in a OMB Cir. A-76 proposal imposed an unwarranted risk to the offeror and an unfair advantage to the in-house offer); Symionics, Inc., B-281199.2, Mar. 4, 1999, 99-1 CPD ¶ 48 (finding the agency conducted a fair cost comparison even though the agency failed to seal the government's management plan and most efficient organization); Gemini Indus., Inc., B-281323, Jan. 25, 1999, 99-1 CPD ¶ 22 (finding the agency acted properly when it evaluated proposals against the estimate of proposed staffing); Omni Corp., B-281082, Dec. 22, 1998, 98-2 CPD ¶ 159 (finding that offerors who participate in the private sector competition, but not selected for comparison with the in-house offer, are entitled to a post-award debriefing).

46. B-281224, Jan. 12, 1999, 99-1 CPD ¶ 19.

47. GENERAL SERVS. ADMIN. ET AL., FEDERAL ACQUISITION REG. subpt. 14.5 (June 1997) [hereinafter FAR]. Two-step sealed bidding is a combination of competitive procedures designed to obtain the benefits of sealed bidding when adequate specifications are unavailable. *Id.* at 14.501. This section goes on to state: "An objective is to permit the development of a sufficiently descriptive and not unduly restrictive statement of the [g]overnment's requirements, including an adequate technical data package, so that subsequent acquisitions may be made by conventional sealed bidding." *Id.* Step one consists of the agency requesting and evaluating technical proposals. In step two, offerors who prepared acceptable technical proposals submit sealed bids. *Id.*

48. *DZS/Baker*, 99-1 CPD ¶ 19 at 2.

49. *Id.* at 3. The technical evaluation team consisted of 16 members. Of those 16 persons, 4 core evaluators and 10 technical advisors held positions under study. A core evaluator reviewed the entire proposal, while a technical advisor reviewed specific portions. *Id.*

50. *Id.*

degree of public trust and an impeccable standard of conduct. The general rule is to avoid strictly any conflict of interest or even the appearance of a conflict of interest in [g]overnment-contractor relationships.<sup>51</sup>

Nowhere in the opinion, however, did the GAO quote or analyze the “except as authorized by statute or regulation” language of FAR 3.101-1. Noting that FAR subpart 3.1 does not address scenarios when agency employees may be unable to render impartial advice to the government, the GAO instead turned its attention to the organizational conflict of interest provisions of FAR subpart 9.5. Relying on several provisions of FAR subpart 9.5, the GAO found it “self evident” that the agency evaluators in this case were potentially unable to advise the contracting officer impartially.<sup>52</sup> In fact, the GAO noted that the agency evaluators were in effect evaluating a competitor’s proposal:

Where, as here, a private-sector offeror submits a technical proposal as part of an A-76 cost comparison study for work currently performed in-house by an agency, and agency personnel holding positions under the study and thus subject to being contracted out are involved in evaluating the commercial offeror’s proposal, it seems self-evident that, as addressed in FAR Section 9.501(d), the agency evaluators are potentially unable to render impartial assistance or advice to the contracting officer—their objectivity in performing the evaluation being impaired.<sup>53</sup>

The Air Force asserted that it took steps to mitigate the conflict of interest. It had segregated the evaluators from the other team members, appointed a procurement analyst whose position was not subject to the OMB Circular A-76 cost study as the technical evaluation team chief, and increased training and surveillance of the cost study. Unpersuaded, the GAO concluded that these steps failed to eliminate or mitigate the conflict.<sup>54</sup> Moreover, the GAO dismissed the contracting officer’s claim that no one but the sixteen employees could perform the technical evaluations, finding it “implausible that there were no other personnel available in the Department of the Air Force who were qualified to evaluate proposals for installation civil operations and maintenance services.”<sup>55</sup> In light of the “significant conflict of interest,” the GAO concluded that the contracting officer failed to take appropriate remedial action and sustained the protest.<sup>56</sup>

*The OGE Approach: Financial Conflict of Interest.*

In *DZS/Baker*, the GAO did not address the financial conflict of interest provisions of 18 U.S.C.A. Section 208.<sup>57</sup> That statute prohibits employees from participating in a particular matter if doing so would have a direct and predictable effect on their financial interests. The OGE implementing regulations, however, exempt employees from the financial conflict of interest coverage in limited situations. In September 1999, nearly nine months after the GAO issued *DZS/Baker*, the Director of the OGE issued a memorandum criticizing the GAO for these “significant omissions” in its analysis.<sup>58</sup>

First, the OGE focused on FAR 3.101-1, upon which the GAO relied as the starting point for its discussion about protect-

51. FAR, *supra* note 47, at 3.101-1.

52. *DZS/Baker*, 99-1 CPD ¶ 19 at 5. The GAO cited FAR 9.501(d), which finds a conflict of interest when, “because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the government, or the person’s objectivity in performing the contract work is or might be otherwise impaired.” FAR, *supra* note 44, at 9.501(d). The GAO also relied on another FAR provision that prohibits a contractor from evaluating its own products or services, or those of a competitor, without proper safeguards to protect the government’s interests. *Id.* at 9.505-3. It analogized the 16 agency evaluators to contractors who may lack objectivity when evaluating a competitor’s proposal. *DZS/Baker*, 99-1 CPD ¶ 19 at 5. Finally, the GAO observed that the FAR vested contracting officers with the duty to identify and mitigate potential organizational conflicts of interest. *Id.* See FAR, *supra* note 44, at 9.504 (charging contracting officers with the responsibility to recognize and either avoid, neutralize, or mitigate organizational conflicts of interest before contract award).

53. *DZS/Baker*, 99-1 CPD ¶ 19 at 5.

54. *Id.* at 6. The GAO further explained:

In our view, given the breadth and severity of the conflict of interest here, the conflict could not be mitigated by an action short of reconstituting the evaluation team. . . . So long as contracting officials relied on the evaluators for their expertise and input, we fail to see how, in this situation, mere additional oversight of the evaluation process would be adequate to mitigate a conflict of interest. Accordingly, assigning an individual without a conflict to be the evaluation team chief, while a step in the right direction, is insufficient to mitigate the conflict. Finally, while segregation may resolve a conflict of interest relating to an offeror’s unfair access to information, it is virtually irrelevant to a conflict of interest involving potentially impaired objectivity.

*Id.*

55. *Id.* The contracting officer admitted that she “could not help but be aware of the potential for a conflict of interest from the Technical Evaluation Team . . .” *Id.* She stated, however, that she could not find anyone else available and qualified to serve on the team. *Id.*

56. *Id.* at 7. On resolicitation, the government group performing these functions won the cost study. See Leroy H. Armes, *Contracting Out: Government Apparent Winner of Contract for Wright-Patterson Engineering Support*, Fed. Cont. Daily (BNA), Oct. 5, 1999, available in LEXIS, News Library, BNAFCDF File.

57. 18 U.S.C.A. § 208 (West 1999).

ing the integrity of the process.<sup>59</sup> The OGE chastised the GAO, however, for ignoring the first sentence of FAR 3.101-1, which requires officials to conduct government business in a manner above reproach, “except as authorized by statute or regulation.” The OGE opined that had the GAO addressed this language and considered both 18 U.S.C.A. Section 208 and its regulations, it might have reached a different conclusion.<sup>60</sup>

In its memorandum, the OGE recognized that evaluating bids or proposals of contractors offering to perform the employee’s duties creates a financial conflict of interest under 18 U.S.C.A. Section 208. As such, the employee could not evaluate the bids or proposals absent a waiver or exemption.<sup>61</sup> The OGE noted, however, that it has exempted from the coverage of 18 U.S.C.A. Section 208 employees who evaluate bids or proposals in an OMB Circular A-76 cost study.<sup>62</sup> Moreover, the OGE reminded readers that this exemption means that the employee’s participation in the matter outweighs any concerns a reasonable person may have about the integrity of the procurement process.<sup>63</sup>

#### *What’s It All Mean?*

The OGE and the GAO have marshaled different approaches and viewpoints when piecing together the conflict of interest puzzle in an OMB Circular A-76 cost study. The GAO zeroed

in on the integrity of the procurement process to find a conflict; conversely, the OGE couched the issue as one of a financial conflict of interest subject to an exemption. Both entities offer compelling reasons to anchor their positions. For practitioners, however, the question is much more immediate: who has the last word, the GAO or the OGE? Certainly, the ethics “turf” belongs to the OGE, while the GAO monitors the procurement landscape. When the two areas collide, as they did in *DZS/Baker*, the GAO’s approach is arguably better reasoned but creates unique issues of its own. For example, will agencies have the staffing to keep the process as clean as the GAO says it must be? Regardless, at every milestone, those responsible for the cost study must be sensitive to *all* conflicts of interest. The agency must exercise good business judgment to avoid situations that taint the overall procurement. In this area, practitioners can perform a valuable service for their clients by helping them identify and then resolve the conflicts of interest.

Until this standoff is resolved, practitioners and their clients are wise to follow the adage: “Better safe than sorry.” Otherwise, an unhappy private offeror may cry “foul” to the GAO. As a ready avenue for relief, the GAO has sent a ringing message to agencies: avoid the pitfalls of *DZS/Baker*, or risk starting over. Major Harney.

---

58. Memorandum, Director, Office of Government Ethics, to Designated Agency Ethics Officials, subject: Section 208 Exemptions for Disqualifying Financial Interests that are Implicated by Participation in OMB Circular A-76 Procedures (Sept. 9, 1999) [hereinafter Section 208 Memorandum], available at <<http://www.usoge.gov/daeogram/1999>>.

59. See *supra* note 51 and accompanying text.

60. Section 208 Memorandum, *supra* note 58, at 2. The OGE also stated:

The Comptroller General did not address the Office of Government Ethics (OGE) exemption under 18 U.S.C. § 208 for employees who participate in particular matters where the disqualifying interest arises from [f]ederal [g]overnment employment. We are issuing this Memorandum to reaffirm the applicability of the exemption at 5 C.F.R. § 2640.203(d) for employees who participate in matters conducted under OMB Circular A-76 procedures.

*Id.* at 1-2.

61. *Id.* at 2.

62. *Id.* at 1-2 (citing 5 C.F.R. § 2640.203(d) (1999)). This section exempts employees from a financial conflict of interest when the disqualifying financial interest arises from federal employment. Thus, the exemption permits an employee to make determinations affecting an entire office or group of employees, even though the employee is a member of that group. The employee may not, however, make determinations that would affect only his salary and benefits. *Id.*

63. *Id.* at 2 (citing 5 C.F.R. § 2635.501).