

OLYMPIA J. SNOWE, MAINE, CHAIR
JOHN F. KERRY, MASSACHUSETTS, RANKING MEMBER
CHRISTOPHER G. BOND, MISSOURI
CONRAD BURNS, MONTANA
ROBERT F. BENNETT, UTAH
MICHAEL ENZI, WYOMING
PETER G. FITZGERALD, ILLINOIS
MIKE CRAPO, IDAHO
GEORGE ALLEN, VIRGINIA
JOHN ENSIGN, NEVADA
NORM COLEMAN, MINNESOTA
CARL LEVIN, MICHIGAN
TOM HARKIN, IOWA
JOSEPH I. LIEBERMAN, CONNECTICUT
MARY LANDRIEU, LOUISIANA
JOHN EDWARDS, NORTH CAROLINA
MARIA CANTWELL, WASHINGTON
EVAN BAYH, INDIANA
MARK PRYOR, ARKANSAS

EMILIA DI SANTO, REPUBLICAN STAFF DIRECTOR
PATRICIA R. FORBES, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510-6350

June 24, 2003

Dov S. Zakheim
Under Secretary of Defense
Comptroller and Chief Financial Officer
1100 Defense Pentagon
Washington, DC 20301-1100

Michael W. Wynne
Acting Under Secretary of Defense
Acquisition, Technology and Logistics
3010 Defense Pentagon
Washington, DC 20301-3010

Dear Mr. Zakheim and Mr. Wynne:

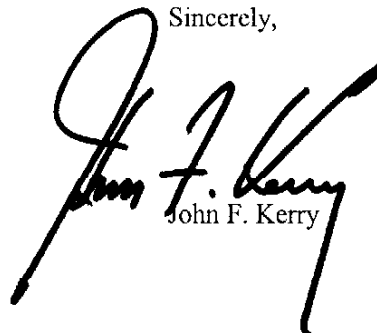
It has been brought to my attention that the Defense Contract Audit Agency (DCAA) is disallowing government contractors that have elected S Corporation tax treatment to recoup state taxes as reimbursable, allowable costs, while reimbursing larger C Corporations for such taxes. I have a number of concerns regarding the possible deleterious affect this decision could have on small businesses.

In *Information Systems & Network Corp. v. United States*, No. 98-663C, 265, 265-272 (Fed. Cl. Nov. 30, 2000), the U.S. Court of Federal Claims found that the Federal Acquisition Regulations ("FAR") does, in fact, allow reimbursement of state taxes by contractors performing contracts as commercial organizations regardless of their tax elections. In the ruling, the court stated that, "*Indeed, S Corporations are small businesses and their corporate structure is meant to help, not hinder, the growth and health of these businesses. It is the general intent of the FAR to aid and encourage small businesses as well.*"

Further, pursuant to the Regulatory Flexibility Act of (5 U.S.C. 601-612), the Department of Defense is required to prepare an analysis indicating how the agency's decision would affect smaller entities, particularly small businesses. I would like your assistance in reviewing this matter to determine whether it is permissible for the Department of Defense to reimburse S corporations performing government contracts for state taxes, as they do for larger C corporations. I am sure we can find a solution that will level the playing field for both C corporations and S corporations.

I look forward to working with you and your staff this important issue.

Sincerely,


John F. Kerry