A FURTHER LEGAL INQUIRY INTO RENEGOTIATION: I

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RENegotiation has undergone some important changes which call for consideration. Congress has undertaken to rewrite the Renegotiation Act. Administrative and procedural developments have created new problems. The act is being attacked as unconstitutional. Procedural technique and statutory interpretations have crystallized sufficiently to permit careful scrutiny. And the problems regarding the determination of excessive profits, questions of taxation, amortization, cost allowances, as well as the constitutionality of the act, are a challenge to a continued study of this law and its administration.

Changes and Problems Created by the Revenue Act of 1943

These demand first attention. Renegotiation has been changed but its fundamental concepts remain the same. Congress conducted a constant examination of the Renegotiation Act almost from the time of its enactment. It has been continuously considering proposed changes. The problems presented to Congress created by the act have resulted in a series of four amendments. The first of these was largely for the purpose of clarification and a better definition of the scope of the

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Previous articles by Major Steadman dealing with renegotiation have appeared in the August, 1943, and the February, 1944, issues of the Review.

1 The Senate Committee on Naval Affairs, House Committee on Ways and Means, House Committee on Naval Affairs, House Committee on Appropriations, and Senate Committee on Finance have all held hearings examining renegotiation.

act. The second amendment added four subsidiaries of the Reconstruction Finance Corporation as renegotiating agencies—Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company. The third amendment extended the definition of “subcontract” so as to bring within the scope of the act brokers, agents and commission men receiving $25,000 or more during any fiscal period from contracts or subcontracts with the renegotiating departments. The fourth amendment is by the Revenue Act of 1943 which is the most far-reaching and comprehensive change that has been made in the act. A complete rewriting of the law was undertaken. Nevertheless, the revisions that have been brought about are primarily as to form rather than substance. The underlying theory of renegotiation as an instrument for the elimination of excessive or exorbitant profits from war contracts remains unaltered. This policy is unchanged.

In understanding the effect of the amendments to the Revenue Act of 1943, it is perhaps equally as important to examine those things that Congress did not do as to study the changes that were made. Among the changes that Congress was asked to provide for were these:

1. A redefinition of subcontract so as to eliminate from renegotiation all but those subcontractors furnishing items that become a part or component of the final article furnished to the renegotiating agencies. Such an amendment would eliminate the manufacturers of machine tools, for example.

2. The determination of excessive profits after, rather than before, taxes.

3. The setting up of reserves for postwar rehabilitation of plant and equipment.

4. Eliminating from renegotiation the sale of standard commercial articles to the war agencies.

5. A fixed percentage of profit formula for determining the excessiveness of profits realized through doing business with the renegotiating agencies.

6. A review by either the Tax Court or the Court of Claims.

7. Raising the exemption measured by the dollar volume of business with renegotiating agencies from $100,000 to $500,000.

8. Extending the mandatory exemptions to agricultural products.

9. Exempting construction contracts from renegotiation.

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10. Close adherence to the allowances, deductions and exclusions as provided in the Internal Revenue Code and to the method of cost accounting regularly employed by the contractor as the basis for determining costs.

11. Allowance of the amortization deduction in the event of a recomputation as provided in section 124(d) of the Internal Revenue Code on account of an acceleration of the amortization period for privately financed war facilities.

12. Recognizing as an item of cost in renegotiation, the carryover and carry-back provisions of the Internal Revenue Code.

Many of these proposals found their way into the act but there were many things that Congress did not adopt. Subcontract was not redefined except to exclude office supplies from renegotiation. There was no change made requiring the determination of excessive profits after, rather than before, taxes. The setting up of reserves for postwar rehabilitation of plant and equipment did not receive congressional sanction. Standard commercial articles were not eliminated from renegotiation but provision was made to permit the administrators of the act to eliminate such items in the exercise of administrative discretion where the competitive conditions affecting the sale of these articles are such as to protect the Government against excessive prices, that is, to insure that excessive profits are not being realized by any significant segment of the industry producing and selling such articles. The suggestion that renegotiation be conducted by the application of a fixed percentage of profit formula to income was rejected. The carryover and carry-back provisions of the Internal Revenue Code were not extended to renegotiation. Congress provided, however, for review by the Tax Court. The exemption measured by the dollar volume of business with the renegotiating agencies was raised from $100,000 to $500,000. The 1943 Act specifically exempts contracts or subcontracts for agricultural commodities in their basic state. Construction contracts wherein competition is provided under certain conditions have been exempted and adherence to the allowances, deductions and exclusions as provided in chapters 1 and 2E of the Internal Revenue Code and to the method of cost accounting regularly employed by the contractor as the required basis for determining costs has been adopted. Moreover, the allowance of the amortization deductions in the event of a recomputation through an acceleration of the amortization period, as provided in section 124(d) of the Internal Revenue Code, has been incorporated in the act. There have been many other changes which will be discussed at length but the importance of this observation here
is that Congress, after examining all of these proposals, determined to leave the fundamentals of renegotiation unaltered.

**General Outline of the New Law**

The amendments to section 403 of the Sixth Supplemental National Defense Appropriation Act, as amended, the Renegotiation Act—that have been made by section 701(b) of the Revenue Act of 1943 constitute a rewriting of the Renegotiation Act. This new statute is applicable to all fiscal years ending after June 30, 1943. Certain portions of it are also effective with respect to fiscal periods ending before July 1, 1943. This is by virtue of the fact that parts of section 701(b) are retroactive to April 28, 1942, the effective date of section 403 as originally enacted. Other provisions of section 701(b) became operative on the effective date of the Revenue Act of 1943, February 25, 1944. The remaining provisions of section 701(b) are effective only as to fiscal years ending after June 30, 1943. Thus, in applying rene-

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1. Subsections (a) (4) (C) and (a) (4) (D), relating to the allowance of the recomputed unused amortization deduction;
2. Subsection (i) (1) (C), relating to the exemption of contracts or subcontracts for certain agricultural commodities;
3. Subsection (i) (1) (D), relating to the exemption of contracts or subcontracts with charitable, religious, or educational institutions;
4. Subsection (i) (1) (F), relating to the exemption of subcontracts under prime contracts or other subcontracts exempted under paragraph one of subsection (i);
5. Subsection (i) (3), relating to a fair cost allowance for certain raw materials and agricultural products in the exempted state in the case of integrated producers and to the exclusion from renegotiation of profits realized which are attributable to the increment in value of an excess inventory; and
6. Subsection (1), which gives section 403 the short title of the “Renegotiation Act.”

Subsection (e) (2) which relates to a redetermination of excessive profits by the Tax Court of the United States where unilateral determinations have been made by the secretaries of the departments with regard to fiscal years ending prior to July 1, 1943 also provides for redetermination by the Tax Court of excessive profits for those fiscal years ending before July 1, 1943 and should be considered in conjunction with the Renegotiation Act of 1942.

6 See note 5 supra.
negotiation to a fiscal year ending before July 1, 1943, section 403, as amended, prior to the enactment of section 701(b) together with those provisions of section 701(b) made applicable to such fiscal years, will govern such a renegotiation. The renegotiation of fiscal years ending after June 30, 1943 will be upon the basis of section 701(b). For ease of identification in this article section 701(b) of the Revenue Act of 1943 will be called the "1943 Act." Where the Renegotiation Act is referred to as it existed prior to the enactment of section 701(b), it will be called the "1942 Act." Fiscal years ending before July 1, 1943 will sometimes be stated as "1942 fiscal years," after June 30, 1943, as "1943 fiscal years."

The statutory revisions brought about by the Revenue Act of 1943 fall generally in these categories:

1. Procedural changes which relate to the organization for the conduct of renegotiation, methods of review, periods of limitations and the discontinuance of renegotiation.

2. Alterations primarily in reference to the way in which excessive profits are to be determined. These amendments establish certain statutory standards, direct that contracts shall be renegotiated in the aggregate rather than individually, define profits and specify allowable costs, exclusions and deductions.

3. Amendments of an exempting and exclusionary nature which recast the area embraced by renegotiation.

4. An amendment relative to the tax effect of renegotiation.

Procedure

Organization for Renegotiation

Section 701(b) of the Revenue Act of 1943 establishes an overall agency for the administration of renegotiation known as the War Contracts Price Adjustment Board. Under the law, prior to the enactment of this amendment, the renegotiating authority was placed with the


8 See note 5 supra.

9 Subsection (d) (1) of the 1943 Act.
secretaries or heads of the War, Navy and Treasury Departments, the Maritime Commission and the four subsidiaries of the Reconstruction Finance Corporation. The War Shipping Administration also had renegotiating authority.

With regard to fiscal years ending on or before June 30, 1943 renegotiating authority will still be exercised by these departments although the final authority to make a determination of excessive profits is now vested in the Tax Courts of the United States for these fiscal years where an agreement had not been made for the elimination of excessive profits at the time the Revenue Act of 1943 became effective, a point which will be more fully discussed hereafter. The powers conferred upon the War Contracts Price Adjustment Board are effective only in relation to fiscal years which end after June 30, 1943 although the section of the statute establishing this board was effective February 25, 1944.

What is this board? It is an administrative agency composed of one representative each from the War, Navy and Treasury Departments, the Maritime Commission or the War Shipping Administration, the Reconstruction Finance Corporation and the War Production Board. It has the authority to conduct renegotiation under regulations which it may promulgate and may delegate its authority to the secretary of any of the departments named in the act in any way that it deems desirable. The secretary, in turn, may redelegate this authority in whole or in part to such officers or agencies as he may designate. This central board was established as the result of the insistence in Congress that coordination between the departments having renegotiating authority under the prior act be not a matter of voluntary cooperation but one of statutory necessity. The War Contracts Price Adjustment Board, in fact, operates as a central coordinating agency exercising final authority in the determination of renegotiation policy, and the promulgation of regulations. It is the agency to which Congress looks in the renegotiation of those fiscal periods ending after June 30, 1943, over which it exercises authority. The actual operation and conduct of renegotiation, however, is proceeding in much the same way that it did

10 Subsection (a) (1) of the 1942 Act.
11 For an explanation of how the War Shipping Administration derives its renegotiating authority from certain executive orders, see Steadman, "Legal Aspects of Renegotiation," 42 Mich. L. Rev. 545 at 549 (1944).
12 Subsection (e) (2) of the 1943 Act.
13 February 25, 1944.
14 Subsection (d) (1) of the 1943 Act.
15 Subsection (d) (4) of the 1943 Act.
before in the sense that the departments, contracts with which are renegotiable, have been delegated the authority to carry on renegotiation with the contractors through the existing renegotiation boards that had been established throughout the country.\textsuperscript{16} The War Contracts Price Adjustment Board has retained the authority to review determinations of excessive profits made by the departments not embodied in agreements and retains for itself the authority to issue regulations governing the conduct of renegotiation,\textsuperscript{17} as well as the power to assign contractors to the departments for renegotiation. And it is only with respect to those contractors which the board assigns that the delegated authority may be exercised.

\textit{Commencement of Renegotiation and Filing of Statements}

The Renegotiation Act as it stood immediately prior to these amendments and remaining effective with respect to 1942 fiscal years, does not specify the procedure to be followed in commencing renegotiation. The secretary of the department concerned is merely directed to require renegotiation of a contractor or subcontractor who is, in the opinion of the secretary, realizing excessive profits from his contracts or subcontracts with the renegotiating agencies.\textsuperscript{18} The 1943 Act, however, details the method in which the board (and those agencies to which the board has delegated its authority) is to begin renegotiation. A reasonable notice of the time and place for the renegotiation conference is required and this act stipulates that the mailing of a notice by registered mail “to the contractor or subcontractor shall constitute the commencement of the renegotiation proceeding.”\textsuperscript{19} Apparently these provisions were inserted in an effort to satisfy procedural due process.

The 1943 Act requires that every contractor who receives or to whom there accrues in any fiscal year ending after June 30, 1943 an aggregate amount in excess of $500,000 from renegotiable contracts or subcontracts must file certain financial statements in the form which the War Contracts Price Adjustment Board has prescribed.\textsuperscript{20} In determining whether the contractor must make such a filing, the contracts and subcontracts exempted pursuant to section (i) of the act which

\textsuperscript{16} Pursuant to subsection (d) (4) of the 1943 Act. This delegation of authority is found in Renegotiation Regulations, 821.1; C.C.H. \textit{War Law Service} \S 5821.1.

\textsuperscript{17} The War Contracts Price Adjustment Board has issued these regulations known and cited as “Renegotiation Regulations.”

\textsuperscript{18} Subsection (c) (1) of the 1942 Act.

\textsuperscript{19} Subsection (c) (1) of the 1943 Act.

\textsuperscript{20} Subsection (c) (5) (A) of the 1943 Act.
provide statutory and administrative exemptions must be included. However, subcontracts as defined in subsection (a) (5) (B) relating to the employment of agents and brokers may be excluded. With respect to those subcontracts described in subsection (a) (5) (B), the person who holds such contracts in excess of $25,000 must also file these statements. If the fiscal year is a fractional part of twelve months, the $500,000 and $25,000 figures are reduced to the same "fractional part thereof" for determining whether filing is mandatory. Moreover, if the aggregate amounts received or accrued in any fiscal year by a contractor or subcontractor "and all persons under the control of or controlling or under common control with the contractor or subcontractor" are in excess of $500,000, or $25,000 in the case of the subcontracts held by agents or brokers, these statements must be filed.

These statements must be filed by the contractor with the board on or before the first day of the fourth month following the close of the fiscal year subject to renegotiation. Where a fiscal year ending after June 30, 1943 was closed when the Revenue Act of 1943 became law, statements were to have been filed by June 1, 1944.

Penalties are imposed for a wilful failure to file or furnish information, records, data or for making false statements or for furnishing false and misleading records.

Under renegotiation prior to these recent amendments it was the practice, and so remains regarding 1942 fiscal years, to request of the contractor certain financial information which would form the basis of an opinion as to whether renegotiation ought to be commenced in the case of a particular contractor. Procedure with regard to 1943 fiscal years will remain very much the same except that the information instead of being submitted to one of the departments will be forwarded to the War Contracts Price Adjustment Board which, after studying the case, will send it to one of the renegotiating agencies if excessive profits seem present with instructions to commence renegotiation. The 1942 Act holds only one requirement relative to filing statements. That is with regard to the running of the statute of limitations regarding fiscal years. This filing is not mandatory but it provides a way for the contractor to commence the running of the limitation period

21 Subsection (c) (6) of the 1943 Act.
22 The criteria for determining control is discussed under the sections of this article dealing with exempting and exclusionary amendments.
23 Subsection (c) (5) (A) of the 1943 Act.
24 Ibid.
25 Subsection (c) (5) of the 1942 Act.
with respect to aggregate amounts received from renegotiable contracts and subcontracts during fiscal years ending prior to July 1, 1943. In the case of individual contracts subsection (c)(6) of the 1942 Act provides for the running of the statute of limitations within one year after the close of the fiscal year during which the contract or subcontract was completed or terminated and this limitation period bars the renegotiation of such a contract irrespective of the time when the financial report is filed. After the mandatory filing is made under the 1943 Act, renegotiation is then commenced as provided in that act by the mailing of a notice to the contractor by registered mail.

**Conduct of Renegotiation**

As has been true in the past, renegotiation continues to be generally conducted with the contractor by that agency with whom he has had the preponderance of his renegotiable business during the fiscal period under review. However, certain types of business have been entirely assigned to one agency in an effort to achieve the greatest uniformity of result. For example, the machine tool industry has been assigned for renegotiation largely to the RFC Price Adjustment Board.

In the renegotiation of 1942 fiscal years the contractor is asked to meet with renegotiators with a view to arriving at an agreement for the elimination of excessive profits but this method of handling a case was established by administrative regulation rather than statute. The 1943 Act as applied to 1943 fiscal years requires, however, that there be a conference between the contractor and the renegotiating agency at which an effort shall be made to reach an agreement for eliminating unreasonable profits. If it is not possible to reach such an agreement the 1943 Act stipulates that an order shall be entered determining the amount of excessive profits and requiring their elimination. When this unilateral determination is made the procedure established in the new act requires that the contractor receive a notice concerning it by registered mail.27

The 1942 Act permits renegotiation by individual contracts but this is not true under the 1943 Act for years ending after June 30, 1943. Renegotiation must be conducted with regard to the aggregate amounts received under contracts or subcontracts held by a contractor unless the contractor or subcontractor requests and the War Contracts Board agrees to renegotiation of contracts individually or as two or

26 Subsection (e)(1) of the 1943 Act.
27 Subsection (c)(1) of the 1943 Act.
more groups.\textsuperscript{28} It is the practice of the renegotiating departments, under the 1942 Act, to conduct renegotiation with very minor exceptions upon a fiscal year basis. Congress decided to give the contractor the assurance that this practice would be followed, but at the same time it provided a means for conducting a renegotiation on other than a straight fiscal year basis if some such other method is mutually agreeable to the contractor and the Government.

An interesting feature of the 1943 Act is the requirement that whenever excessive profits are determined for a fiscal year ending after June 30, 1943, either by way of agreement or by a unilateral order, the contractor must be furnished, at his request, a statement of the facts which form the basis for the determination and the reasons for making it.\textsuperscript{29} Two reasons appear for this change in the act. Some contractors complained that the renegotiation boards were making findings of excessive profits without disclosing the reasons for their actions and that the contractor, therefore, had no way of knowing how this decision was achieved. It also seems likely that this is a further move to meet the requirements of procedural due process.\textsuperscript{30} As already mentioned, this statement is to be furnished only upon the request of the contractor and it does not clearly appear from the statute whether the contractor in those instances where renegotiation results in an agreement is entitled to receive the statement before the agreement is reached.\textsuperscript{31} Although the statute strictly construed appears only to require that the statement be furnished in such cases after the agreement is made, it seems reasonable to believe that Congress intended that the statement be furnished to the contractor prior to the execution of the agreement so as to assist him in determining whether the renegotiating agencies have given due consideration to all of the aspects of his case. If the statement were to be furnished only after an agreement had been executed it would probably be of less assistance in

\textsuperscript{28} Subsection (c) (1) of the 1943 Act.
\textsuperscript{29} Subsection (c) (1) of the 1943 Act.
\textsuperscript{30} However, compare Schechter Poultry Corp. v. United States, 295 U.S. 495, 55 S. Ct. 837 (1935) wherein the court indicated that it was of no consequence that the National Industrial Recovery Act, Act of June 16, 1933, required that the company be informed of the reasons for the administrators' actions as a constitutional test.
\textsuperscript{31} "Whenever the Board makes a determination with respect to the amount of excessive profits, whether such determination is made by order or is embodied in an agreement with the contractor or subcontractor, it shall, at the request of the contractor or subcontractor, as the case may be, prepare and furnish such contractor or subcontractor with a statement of such determination, of the facts used as a basis therefor, and of its reasons for such determination." Subsection (c) (1) of the 1943 Act.
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administering the act. It may have been contemplated that such a statement would also serve as a check upon the administrators requiring a more careful adherence to the law. The War Contracts Price Adjustment Board, believing that the contractor should have this statement before he signs the agreement if he wishes it, has issued a regulation which permits its issuance despite the act's failure to clearly require it.82

The Renegotiation Agreement

The provisions of the Renegotiation Act with regard to the finality of agreements have not been changed. There are certain differences, however, with regard to other aspects of renegotiation agreements made under the 1943 Act for 1943 fiscal years.

In past renegotiations it has been the practice to ask the contractor to agree to an examination of his prices with a view to price reductions for the purpose of preventing the creation of excessive profits in the next succeeding fiscal period.88 The 1943 Act, however, permits the inclusion of provisions with respect to "the elimination of excessive profits likely to be received or accrued," that is, with regard to forward pricing, as it is known in Government procurement jargon, only with the consent of the contractor.84 This is a result of the separation of the recapture and repricing powers brought about by the Revenue Act of 1943 for fiscal years after June 30, 1943. The power of pricing for future deliveries has been separated from renegotiation and placed in the hands of the procurement agencies through section 801 of the Revenue Act of 1943—the Repricing of War Contracts Act. The power to recapture remains encompassed by renegotiation. Since another means is provided for assuring fair prices for the future delivery of war goods the 1943 Act does not regard forward pricing as an essential feature of the renegotiation processes. However, the policy of the departments conducting renegotiation remains that they will seek a forward pricing agreement with the contractor if such is agreeable to him in order to accomplish the objectives of the Repricing of War Contracts Act at the same time that renegotiation is conducted.85

The 1943 Act with regard to 1943 fiscal years has somewhat broadened and made more definite the scope of authority held by the administrators of the law in that it now specifically provides that the

82 Renegotiation Regulations 524.1; C.C.H. War Law Service ¶ 5524.1.
83 The clause covering this point appeared to impose no more than a moral obligation and was frequently referred to as the "Boy Scout Clause."
84 Subsection (c) (1) of the 1943 Act.
85 Renegotiation Regulations 506.2; C.C.H. War Law Service ¶ 5506.2.
renegotiation agreement may include, in addition to provisions for the elimination of excessive profits, terms and conditions covering such other matters relating thereto as the War Contracts Price Adjustment Board deems advisable. This should facilitate the administration of the act. Aside from any statutory provisions certain policies have been established by the administrators concerning provisions which are not acceptable as a part of the renegotiation agreement. Important among these is the refusal on the part of the Government to include clauses in renegotiation agreements which will in any way impair the finality of the agreement. This simply means that the agreement must not permit its being reopened or altered in the event that the act is amended or declared unconstitutional or in case an interpretation is changed or new exemptions are created. Except in two cases no provision calling for a refund by the Government under any circumstances is to be allowed. One exception is because of the recomputation of the amortization deduction which is provided in subsection (a)(4)(D), and the other is with respect to the refund for excess inventory profit under subsection (i)(3), both of these provisions being in the 1943 Act and retroactive to April 28, 1942.

The position has also been taken that the renegotiators should not ordinarily include in the original agreement provisions for the payment of interest on installments of the amount to be repaid. In the event of active default by the contractor, however, it is likely that interest payments will be required.

Provisions for Review

In those cases where there is a failure on the part of the contractor and the administrators to agree a unilateral determination will be made by the department conducting the renegotiation. One of the most fundamental changes effected through the amendments of the Revenue Act of 1943 is that providing for an administrative review of such determinations. The 1942 Act makes no mention of review, either administrative or judicial. But with regard to all fiscal years ending after June 30, 1943, the 1943 Act establishes a procedure whereby the War Contracts Price Adjustment Board may, on its own motion, initiate a review of any determination of excessive profits made by any of the

88 Subsection (c) (1) of the 1943 Act.
87 Renegotiation Regulations 507.1; C.C.H. War Law Service ¶ 5507.1.
88 Renegotiation Regulations 507.2; C.C.H. War Law Service ¶ 5507.2.
89 Renegotiation Regulations 422.4; C.C.H. War Law Service ¶ 5422.4.
40 Renegotiation Regulations 821.1; C.C.H. War Law Service ¶ 5821.1.
renegotiating agencies. However, if the board does not initiate a review within sixty days from the date of the determination then the determination becomes that of the board itself.\textsuperscript{41}

If the contractor decides to request a review of the determination of excessive profits which has been made by the department conducting the renegotiation he must do so within sixty days after the determination has been made. The board then has sixty days within which to initiate such a review and if it is not commenced within that period then the determination becomes final and is considered to be that of the board. The power of the board to review cases extends to permit it to find a greater or a lesser amount or the same amount of excessive profits as has been determined by the department which has made the finding.\textsuperscript{42}

The 1943 Act establishes the Tax Court of the United States as the final reviewing agency in renegotiation. A contractor, dissatisfied with the finding of the board for a 1943 fiscal year, may lodge an appeal with the Tax Court asking for a redetermination of the amount established by the board. Such a petition for review must be filed within ninety days after the board's determination has been made.\textsuperscript{43}

The Tax Court is also now empowered to make the final determination of excessive profits with respect to fiscal years ending before July 1, 1943.\textsuperscript{44} Review of determinations made for such years by this agency separates itself into two phases. First, where at the time that the Revenue Act of 1943 became effective a unilateral determination had been made by the secretary of the department conducting a renegotiation with any contractor, that contractor could file a request with the Tax Court for a review of such determination at any time within ninety days after the passage of this act. The time for filing such appeals expired on May 25, 1944 and thirty-six such cases were filed.\textsuperscript{45}

\textsuperscript{41} The board will only review unilateral determinations made by the departments to which the board has delegated authority. Renegotiation Regulations 821.1; C.C.H. War Law Service \$ 5821.1.

\textsuperscript{42} Subsection (d) (5) of the 1943 Act.

\textsuperscript{43} Subsection (e) (1) of the 1943 Act.

\textsuperscript{44} Subsection (e) (2) of the 1943 Act. Subcontractors described in subsection (a) (5) (B) of the 1943 Act (brokers & agents) are not accorded a right to file an appeal with the Tax Court with respect to a unilateral determination for those fiscal years ending before July 1, 1943. Subsection (e) (2) of the 1943 Act.

\textsuperscript{45} Cases now before the U.S. Tax Court relating to renegotiation of fiscal years ending before June 30, 1943 with regard to which a unilateral determination has been made at the time the Revenue Act of 1943 became effective, are as follows:
ondly, where renegotiation was not closed at the time the Revenue Act of 1943 was passed and a unilateral determination is made after that date, the contractor may take his case to the Tax Court if he files such an appeal within ninety days after the determination by the secretary. Of course in none of these instances does an appeal lie where a contractor enters into the renegotiation agreement.

1-R Allen Tool Co. v. Navy Department.
2-R Jack & Heintz, Inc. v. War Department. Has requested a circuit court hearing in Cleveland.
3-R H. E. Wolfe Construction Co., Inc. and J. B. Michel v. War Department. Has requested a circuit court hearing in Jacksonville, Fla.
4-R Antonelli Fireworks Co. v. War Department.
5-R Coyne Electrical School, Inc. v. War Department. Has requested a circuit court hearing in Chicago.
6-R Star Tool & Die Works v. War Department.
7-R Kane Manufacturing Corp. v. War Department. Has requested a circuit court hearing in Pittsburgh, Pa.
8-R Fischer Special Manufacturing Co. v. War Department. Has requested a circuit court hearing in Cincinnati, Ohio.
9-R Aircraft & Diesel Equipment Corp. v. War Department.
10-R National Electric Welding Machines Co. v. War Department.
11-R Peninsular Machine Co. v. War Department. Request for hearing in Detroit.
12-R Ring Construction Corp. v. War Department.
13-R Crucible Steel Casting Co. v. Navy Department.
14-R C. Wallace v. War Department.
15-R Wanda May Wallace v. War Department.
16-R Sam P. Wallace v. War Department.
17-R Bobbie J. Wallace v. War Department.
18-R Frank Wallace v. War Department.
19-R Sue Wallace v. War Department.
20-R The Wheland Company v. War Department (fiscal year April 30, 1942).
21-R The Wheland Company v. War Department (fiscal year April 30, 1943).
22-R Lord Manufacturing Co. v. War Department.
23-R Stein Brothers Manufacturing Co. v. War Department.
24-R National Grinding Wheel Company v. Commissioner of Internal Revenue.
25-R Gear Specialties Co. v. War Department. Requests hearing in Chicago.
26-R Psaty and Fuhrman, Inc. v. War Department.
27-R Nathan Cohen v. War Department.
28-R W. B. Knight Machinery Co. v. War Department. Company has made a request for a Circuit Court hearing in St. Louis, Mo.
29-R Kearney & Trecker Corp. (a Wisconsin corporation) v. Navy Department.
30-R Sale Electric Supply Co. v. War Department.
31-R Standard Pressed Steel Co. v. War Department.
32-R Automatic Screw Products Co., v. War Department.
33-R Pennsylvania Manufacturing Co., Inc. v. War Department.
34-R Kellburn Manufacturing Co., Inc. v. War Department.
35-R Phillips Machinery Co. v. War Department.
36-R Auto Specialties Manufacturing Co. v. War Department.

Subsection (e) (2) of the 1943 Act.
The Tax Court of the United States is not a court. It is an administrative body. The review, therefore, which the Tax Court conducts is an administrative review and whether resort thereafter may be had to the courts is a problem which will be discussed later. Exclusive and final jurisdiction is conferred upon the Tax Court for reviewing determinations of excessive profits in renegotiation. The Renegotiation Act does not permit the determinations of the Tax Court to be reviewed by "any court or agency." The proceeding before the Tax Court is de novo. It is not restricted to issues presented during prior renegotiation proceedings and the Tax Court is not bound by the amount determined by the board. The Tax Court may determine a greater or lesser amount as constituting excessive profits. The statement required to be furnished to the contractor upon his request setting forth the board's basis for making the determination is not binding upon the Tax Court. In fact the statute does not permit such statement to be used as proof of facts or of any of the conclusions which it may contain. The powers of the Tax Court are the same irrespective of the fiscal year which is being reviewed. However, in considering those fiscal years ending before July 1, 1943, as has been seen, appeals will be from determinations of the secretary, and the 1942 Act, together with those sections of the 1943 Act applicable to fiscal years ending before July 1, 1943, will govern the determinations of the Tax Court, whereas the 1943 Act as it relates to 1943 fiscal years will apply to

48 Subsection (e) (1) of the 1943 Act. This raises a nice question as to whether an appeal can be taken to the courts from the Tax Court's determination and what issues, if any, are reviewable there. This is discussed later.
49 Subsection (e) (1) of the 1943 Act.
50 Subsection (e) (1) of the 1943 Act.
51 Subsection (e) (1) of the 1943 Act.
52 Subsections (e) (1) and (e) (2) of the 1943 Act. Subsection (e) (1) provides: "... For the purpose of this subsection the court shall have the same powers and duties, insofar as applicable, in respect of the contractor, the subcontractor, the Board and the Secretary, and in respect of the attendance of witnesses and the production of papers, notice of hearings, hearings before divisions, review by the Tax Court of decisions of divisions, stenographic reporting, and reports of proceedings, as such court has under sections 1110, 1111, 1113, 1114, 1115(a), 1116, 1117(a), 1118, 1120 and 1121 of the Internal Revenue Code in the case of a proceeding to redetermine a deficiency. In the case of any witness for the Board or Secretary, the fees and mileage, and the expenses of taking any deposition shall be paid out of appropriations of the Board or Department available for that purpose, and in the case of any other witnesses, shall be paid, subject to rules prescribed by the court, by the party at whose instance the witness appears or the deposition is taken."
53 Subsection (e) (2) of the 1943 Act.
the Tax Court's consideration of cases which come before it involving those fiscal years. It should be emphasized again that an appeal to the Tax Court is provided only in those instances where no agreement has been entered into between the contractor and the Government with respect to renegotiation. This principle applies irrespective of the fiscal years involved.

Although the contractor may file a petition with the Tax Court appealing from a determination of the board, he remains under obligation to pay to the Government the amount of excessive profits determined by the board while his case is pending in the Tax Court. His filing this petition does not stay the execution of the board's order. 54

Since this is so, suppose the contractor pays the amount of excessive profits determined by the board while his case is pending with the Tax Court and thereafter the Tax Court redetermines the amount of excessive profits finding a smaller amount than the contractor has already paid, how can the contractor recover this overpayment? The Renegotiation Act makes no provision for refund in such a case. Apparently the problem was never presented to Congress, for an examina-

54 Subsection (e) (1) of the 1943 Act. Subsection (e) (2) of the 1943 Act relates to the Tax Court review of the secretary's determinations for 1942 years. It is not clear that an appeal to the Tax Court from an order of the secretary as provided by this subsection is also effective to stay the execution of the secretary's order. The act provides that upon appeal to the Tax Court from an order of the secretary the Tax Court "shall have the same jurisdiction, powers, and duties, and the proceeding shall be subject to the same provisions, as in the case of a petition filed with the court under paragraph (1) . . . ." Subsection (e) (2) of the 1943 Act. The sentence in paragraph (1) relative here reads:

"... The filing of a petition under this subsection shall not operate to stay the execution of the order of the Board under subsection (e) (2)." (Italics supplied). Subsection (e) (1) of the 1943 Act.

It will be noted that the word "Board" is used here and that subsection (e) (2) is mentioned which is only applicable in the 1943 Act and therefore applies only to fiscal years ending after June 30, 1943. Moreover, paragraph (1) referred to in the quotation above in expressing the powers and duties of the Tax Court refers to both the board and the secretary in relation to the procedure before the Tax Court itself. (See note 53, supra.) This part of the act immediately precedes the statement that the filing of the petition shall not act as a stay to the execution of the board's order. Inasmuch as the board and the secretary are specifically adverted to in this section it may be argued that, if Congress had intended the secretary's order to be executed while the contractor's petition was pending in the Tax Court, it might have specifically so stated. Contrary to such a contention it must be recognized that the provision in § 403 (e) (2) directing that in the case of 1942 fiscal year appeals "the proceeding shall be subject to the same provisions" as apply to appeals to the Tax Court for 1943 fiscal years, seems to carry with it an implication that the provision quoted above prohibiting a stay of the board's order also applies in the case of petitions from determinations for 1942 fiscal years which are made by the secretary.
tion of the Congressional Debates and the Committee Reports with regard to the 1943 Revenue Bill reveals no mention of this kind of case.66 The Vinson-Trammel Act,68 which preceded the Renegotiation Act as a profit limitation measure, made express provision to cover specifically situations similar to this. It provided:

"... that if such amount [excess profits] is not voluntarily paid, the Secretary of the Treasury shall collect the same under the usual methods imposed under the Internal Revenue Laws to collect said income taxes: Provided further, That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, ... shall be applicable with respect ... to refunds by the Treasury of overpayments of excess profits into the Treasury."57

Section 322(d) of the Internal Revenue Code which provides for refund of overpayments found by the Tax Court does not overcome this difficulty. Section 322 is relative to refunds for overpayments of taxes to taxpayers. The powers conferred upon the Tax Court by the Renegotiation Act under sections of the Internal Revenue Code all relate to matters of procedure and practice in the Tax Court and do not relate to collections or refunds of taxes. The Renegotiation Act itself provides its own methods of collection but it makes no provisions to recover a refund of overpayment in the circumstances under discussion. It would seem, therefore, that the jurisdiction of the Tax Court extends only to the determination of the amount, if any, of excessive profits.58 The Tax Court is confined to a determination of

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66 It may be that Congress assumed that a refund would be available to the contractor in case of an overpayment resulting from a favorable decision of the Tax Court. In the debates upon the Revenue Bill of 1943, H.R. 3687, Representative Disney of Oklahoma said:

"When the contractor appeals to the Tax Court, there is no stay of the recapture of the money but, of course, a decision by the Tax Court in his favor would entitle him to a refund of amounts that had been recaptured." 89 Cong. Rec., No. 185, dated November 30, 1943, pp. 10251 and 10252.

Nonetheless the Renegotiation Act failed to provide a mechanism for granting such refund.


57 34 U.S.C. (1940) § 496(b).

58 See Commissioner of Internal Revenue v. Gooch Milling & Elevator Co., 320 U.S. 418, 64 S. Ct. 184 (1943). The Board of Tax Appeals (predecessor of the Tax Court) had no jurisdiction to order a refund or credit for tax overpayments, but was limited to the determination of the amount of the deficiency or overpayment. See United States ex rel. Girard Trust Company v. Helvering, 301 U. S. 530, 57 S. Ct. 855 (1937).
excessive profits from which an overpayment may result but it appears to have no power to order a refund of an overpayment. The act establishes the machinery for collection of an additional amount of excessive profits should the Tax Court's determination be higher than that of the board, but it remains silent as to how a refund of an overpayment may be accomplished. If the contractor is to recover the amount of overpayment it would seem that he would have to look elsewhere. He would have to look beyond the Renegotiation Act itself. The probable route that would be available to him for the recovery of this sum would be by the presentation of the claim to the General Accounting Office and appeal therefrom, if necessary, to the Court of Claims. This would be upon the theory that the overpayment was an amount erroneously received and covered into the Treasury. It is difficult, however, to believe that Congress intended such a result. This is the kind of thing to which section 322(d) of the Internal Revenue Code, which provides for refunds of overpayments as determined by the Tax Court, should apply. Certainly no remedy has been provided through this means, but it is a matter which Congress might well take under consideration for remedial action.

59 Ibid.

60 Subsection (c) (2) of the 1943 Act.

61 Revised Statutes, § 236 provides that "all claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office." 31 U.S.C. (1940) § 71; Act of June 10, 1921, c. 18, § 305; 42 Stat. L. 24. Upon presentation of the claim in the General Accounting Office and its allowance, the refund presumably would be made from funds appropriated to meet expenditures under the account on the books of the Government designated "Refunds of Moneys Erroneously Received and Covered." 31 U.S.C. (1940) § 725q. Excessive profits repaid by the contractor under the Renegotiation Act of 1943 are directed to "be covered into the Treasury as miscellaneous receipts" (§ 403 (e) (2)) and would, therefore, appear to be contemplated by the foregoing appropriation. The statute, 31 U.S.C. (1940) § 725q, provides that the "Secretary of the Treasury shall submit with his annual estimates of appropriations an amount necessary to meet expenditures properly chargeable to this account."

If no appropriation should be available, then the Comptroller General would be required to submit the claim for refund of the overpayment "to the Congress by a special report containing the material facts and his recommendations thereon."

62 As to the possibility of an action at common law to recover this overpayment in renegotiation see Stone v. White, 301 U. S. 532 at 534, 57 S. Ct. 851 (1937). There the Court pointed out that an action under the statute to recover a tax erroneously paid or overpaid through an action at law is in fact equitable in its nature being the lineal successor of the common count indebitatus assumpsit for money had and received.
tions while a Tax Court review is pending, it is extremely doubtful that they have the authority to do so, for Congress has specifically directed that excessive profits be eliminated and has provided the means for so doing and has, moreover, stipulated that the filing of a petition with the Tax Court appealing from a determination of excessive profits shall not act to stay the execution of the board’s order.

Statute of Limitations

When renegotiation was originally enacted it had no provisions for a limitation period. This objection was remedied by the amendments of October 21, 1942 whereby section 801 of the Revenue Act of 1942 amended the original law by adding a provision prohibiting the renegotiation of any contract unless such renegotiation was commenced within one year after the close of the fiscal year in which such contract or subcontract was completed or terminated. These provisions are still applicable to all fiscal years ending before July 1, 1943. They remain part of the 1942 Act. Under this act it is also possible for the contractor to start the running of the statute of limitations by the filing of certain financial statements with the secretaries of the departments for any prior fiscal years and, unless the secretary of the department concerned gives notice of the commencement of the renegotiation within one year after the date of the filing of these statements and actually commences the renegotiation procedure within sixty days thereafter, the contractor is relieved from the obligation to renegotiate for the periods which are covered by the filed statement.

These limitation provisions have undergone considerable alteration. New limitation periods applicable to fiscal years ending after June 30, 1943 are based upon the mandatory filing of financial data required with regard to each such fiscal year subject to renegotiation. Renegotiation proceedings with regard to these fiscal years must be commenced within twelve months after the close of the fiscal period concerned or within twelve months from the date of the filing of the mandatory statements, whichever date is later. If the proceedings are not so commenced, then the contractor is discharged with regard to any liability

65 Subsection (c) (5) of the 1942 Act.
66 Subsection (c)(5)(A) of the 1943 Act.
to renegotiate on account of the fiscal year which the statement covers. After notice is given commencing renegotiation an agreement or order which determines the amount of excessive profits realized by the company involved must be made within one year. In other words, the renegotiation, once started, must be completed within a year either by agreement or by an order of the board or the agency to which the board has delegated its authority for the conduct of the renegotiation. When the limitation periods expire, the contractor is discharged from all liability for excessive profits for those fiscal periods which would otherwise have been subject to the act. 67

There are two exceptions to which this limitation period does not apply. If a unilateral determination is made by one of the renegotiating agencies a review of that determination by the board will not be barred because the period has passed whereby the limitation would otherwise become effective. Moreover, the one-year period of limitation may be extended by agreement between the contractor and the Government. 68

**Duration of Renegotiation**

Before amended by the Revenue Act of 1943, the Renegotiation Act was to continue in effect during the period of the war and three years thereafter. 69 The statute now provides that profits received or accrued after December 31, 1944 will not be subject to renegotiation, unless the authority which has been granted to the President to extend the operation of this law to a time not later than June 30, 1945 is exercised. 70 This authority conferred upon the President permits him to extend the operation of renegotiation to the date just mentioned if not later than December 1, 1944 he determines that competitive conditions have not been restored. However, the President is also given the authority, should he extend renegotiation, to determine at a time not later than June 30, 1945 that competitive conditions were restored at any time within the six months prior thereto and, by so proclaiming, renegotiation would not be operative after the date which the President may set within that period. 71

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67 Subsection (c) (3) of the 1943 Act.
68 Subsection (c) (3) of the 1943 Act.
69 Subsection (h) of the 1942 Act.
70 Subsection (h) of the 1943 Act.
71 These provisions for the extension of renegotiation by conferring upon the President authority which he may exercise, if competitive conditions are absent, further emphasize that Congress regards the Renegotiation Law as a wartime necessity because of the absence of competitive forces.
The Renegotiation Act creates an exemption measured by a contractor's dollar volume of sales during a fiscal year directly or indirectly to the renegotiating departments. In determining whether a contractor falls within this exemption certain sales which are actually non-renegotiable because of other exemptions are included in computing the aggregate of receipts and accruals, a point which will later be discussed in detail. The Renegotiation Act as it applies to all fiscal years ending before July 1, 1943, excludes from the area of its operation contractors whose total sales computed in the foregoing manner do not exceed $100,000 during a fiscal year. This figure of $100,000 has now been increased to $500,000 in the 1943 Act. The objective of this was to reduce the renegotiation load by eliminating those smaller businesses whose realization of excessive profits would not essentially affect the war economy. In cases where a fiscal year is but a fractional part of twelve months, in applying this exemption of $500,000, and that of $25,000 which obtains in the case of subcontractors defined in subsection (a)(5)(B) of the Renegotiation Act relating to the renegotiation of fees received by agents and brokers, these figures will be reduced "to the same fractional part." Thus, if the fiscal period under consideration is but six months, the exemption measured by the amount of renegotiable business would be $250,000 and $12,500.

The interpretation of this $500,000 exemption raises four important considerations. What contracts are to be considered in determining its application? Does the act permit a recapture of excessive profits to the extent that when deducted from the total gross income of the contractor the result will be an amount of gross income less than $500,000 or less than $25,000 in the case of subcontractors who are agents and brokers? What is the effect of this exemption in the case of fiscal periods of less than twelve months? How is it applied with relation to an affiliated group within the meaning of section 141(d) of the Internal Revenue Code where the fiscal periods of the respective members of the group differ?

With regard to the first problem as to what contracts are to be considered in applying this exemption: Contracts exempted through

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72 Subsection (c) (6) of the 1942 Act.
73 Subsection (c) (6) of the 1943 Act.
74 Subsection (c) (6) of the 1943 Act.
subsection (i) of the 1943 Act

are to be included in making the computation to ascertain whether $500,000 has been received or accrued from renegotiable contracts during a fiscal year. To be excluded, however, are the brokers' and agents' contracts described in subsection (a)(5)(B). To ascertain whether the amount received or accrued under such subcontracts during any fiscal year exceeds $25,000, the computation will also be made by including sales which are otherwise exempted by the provisions of subsection (i) of the act. The fact, however, that receipts from contracts and subcontracts which are exempted by the provisions of the act are included for determining whether a contractor is subject to renegotiation or not does not mean that the exempted items can be considered in determining whether excessive profits have been realized by a contractor. Items that are exempted from renegotiation cannot be taken into consideration and are not subject to the operation of the act in any other regard save that they are included for the purpose of applying these exemptions relating to the dollar volume of business.

All renegotiable amounts received by persons “under the control of or controlling or under common control with the contractor or subcontractor” must be lumped together in deciding whether a contractor is exempted from renegotiation for having less than $500,000 of sales.

As an example of control under the established regulations, if the A corporation holds more than fifty per cent of the voting stock in the B corporation, the following principles should be followed:

1. **Corporate Control:** A parent corporation which owns more than 50% of the voting stock of another corporation controls such other corporation and also controls all corporations controlled by such other corporation.

2. **Individual Control:** An individual who owns more than 50% of the voting stock of a corporation controls the corporation and also controls all corporations controlled by the corporation.

3. **Partnership Control:** A general partner who is entitled to more than 50% of the profits of a partnership controls the partnership.

4. **Joint Venture Control:** A joint venturer who is entitled to more than 50% of the profits of a joint venture controls the joint venture.

5. **Other Cases:** Actual control is a question of fact. Whenever it is believed that actual control exists even though the foregoing conditions are not fulfilled, the matter may be determined by the Department or Service conducting the renegotiation.
corporation which in turn holds more than fifty per cent of the voting stock in the C, D and E companies and the total renegotiable sales of these corporations is in excess of $500,000 including for this purpose the exempted sales defined in subsection (i) of the act, the A company is subject to renegotiation even though its renegotiable total sales for the purpose of applying this exemption are only $50,000.

It does not appear possible under the 1943 Act for the boards to determine an amount of excessive profits which when deducted from the total gross income of the contractor will leave an amount less than $500,000 or less than $25,000 in the case of agents or brokers.\(^{78}\) In case a fractional fiscal period is involved in renegotiation these amounts will be regarded proportionately.\(^{79}\)

Renegotiation is frequently undertaken with affiliated groups, parent and subsidiary corporations, on a consolidated basis. The problem occurs as to how the $500,000 exemption is to be applied where the fiscal years of the various members of the group differ. This illustration will answer the point. Assume the group consists of a parent and two subsidiaries. Control of the subsidiaries rests with the parent. Assume further that the application of the exemption is being made to the parent. The fiscal year of the parent is a calendar year. The fiscal year of the first subsidiary begins October 1 and ends September 30, while the fiscal year for the second subsidiary begins on April 1 and ends March 31. If, during the parent company's fiscal year, both the parent and its subsidiaries received amounts from contracts and subcontracts subject to renegotiation including those exempted under subsection (i), as already discussed, in excess of $500,000, then the affiliated group falls within the purview of the act and is subject to renegotiation. And if their receipts from those subcontracts as defined in subsection (a)(5)(B) of the act for the parent's fiscal year exceed $25,000, then the group is subject to renegotiation both with regard to the amounts received as fees or commissions under subsection (a)(5)(B) of the act and other receipts from renegotiable business.\(^{80}\)

The 1942 Act provides an exemption of contracts made by one of the renegotiating departments with any other department, bureau or agency of the Government, with states or local political subdivisions or with foreign governments.\(^{81}\) This exemption is included in the 1943

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\(^{78}\) Renegotiation Regulations 348.3; C.C.H. War Law Service \|$ 5348.3.  
\(^{79}\) Subsection (c) (6) of the 1943 Act.  
\(^{80}\) Renegotiation Regulations 348.2; C.C.H. War Law Service \|$ 5348.2.  
\(^{81}\) Subsection (i) (1) (i) of the 1942 Act.
Moreover, the exemption relative to contracts and subcontracts for the products of mines, oil or gas wells, mineral deposits and the like and with relation to timber which has not been treated beyond the first form suitable for industrial use is retained in the law. Under the 1942 Act Congress authorizes the departments to exempt agricultural products and regulations have been issued which extend this exemption to many farm products. Apparently Congress wanted to

82 Subsection (i) (1) (A) of the 1943 Act.
83 The Senate Committee on Finance commented favorably upon the interpretation which the secretaries had given this exemption under the 1942 Act. This congressional recognition should be helpful in the administration of this exempting provision. The text of both the 1942 and 1943 Acts in this respect is the same. The Senate Committee on Finance in reporting the 1943 Revenue Bill said:

"It has been brought to the attention of the committee that the interpretation of the exemption of products of a mine, oil or gas well, or other mineral or natural deposits, or timber, which have not been processed, refined, or treated beyond the first form or state suitable for industrial use, as made by the departments whose contracts were originally made subject to renegotiation, has been questioned both by representatives of industry and by representatives of other departments of the Government. There has been suggested on the one hand that the state at which the exemption should have been applied was at a point closer to the depletion line and, on the other hand, certain representatives of industry have taken the position that the exempt status of certain other products has been set at a state prior to the first form or state at which the same were suitable for industrial use. After consideration of the published regulations and exemptions of the departments in connection with this provision of the law, it was concluded that the application thereof which had been adopted by the departments was appropriate and within the limits of the discretion vested in the departments by the Congress to define, interpret, and apply this provision of the statute. Consequently, this section has been reenacted in its original form and, at the suggestion of the departments, there has been added a provision expressly authorizing the making of appropriate cost allowances in the case of an integrated producer who processes an exempted product up to and beyond the first form or state suitable for industrial use in order to place such producer in a position comparable with that of other producers who sell such products at the exempt stage." S. Rep. No. 627 on H.R. 3687, 78th Cong., 1st sess., December 22, 1943, pp. 35-36, ¶ 13 (Committee on Finance).

The list of exempted products is defined in Renegotiation Regulations 841; C.C.H. War Law Service ¶ 5841. Note that the products listed in this regulation are exempt only when they represent products of a mine, oil or gas well, or other mineral or natural deposit, or timber, which have not been processed, refined or treated beyond the first form or state suitable for industrial use and are not exempt if manufactured from raw materials which do not fall within the above description or which have at some prior stage been processed, refined or treated beyond such first form or state suitable for industrial use. For example, magnesium products derived from sea water, products manufactured from the atmosphere, secondary aluminum pigs and ingots, and other similar products are not considered exempted products. Renegotiation Regulations 841 (3); C.C.H. War Law Service ¶ 5841.

84 Subsection (i) (3) of the 1942 Act.
85 War Department Procurement Regulations, ¶ 1292; 2 C.C.H. War Law Service ¶ 23,372.
be certain that there would be no attempt to renegotiate the farmers so the amendments to the Revenue Act of 1943 exempt specific agricultural commodities and extend to contracts for agricultural products in their "raw or natural state." This exemption is made retroactive to April 28, 1942, and thus obtains to all fiscal years.

Charitable organizations such as are defined in section 101(6) of the Internal Revenue Code are exempted from renegotiation as of April 28, 1942 through the amendments made by the Revenue Act of 1943.

An interesting problem accompanies both of these exemptions. Renegotiation with certain contractors may have resulted in a determination of excessive profits in instances where the contractor's income included amounts received from the sale of these now exempted commodities. But there appears to be no provision—aside from the one relating to the increment in value of excess inventory which will be discussed later—which would permit the contractor to recover any of the amounts which he has paid or has agreed to pay as excessive profits. It may be that this apparent omission from the statute will be of considerable importance especially to growers of cotton, tobacco and sugar cane and to dealers in wool. If these producers have entered into renegotiation agreements providing for the return of excessive profits determined upon the basis of a contractor's income which included the amount derived from the sales of these commodities, it appears that they are without recourse either to recover any amounts so paid or to be relieved from the obligation of their contract to continue payments. The law provides no method for reopening such agreements under these circumstances. Where, however, renegotiation agreements have not been made then the renegotiation must be conducted by the secretaries of the departments, by the board and Tax Court with the amounts received from the sale of these exempted items excluded from income in determining the existence of excessive profits.

Salutary among the exemptions of the 1943 Act is that which directs that the act shall not apply to "(E) any contract with a Department, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility." This particu-

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86 Subsection (i) (1) (C) of the 1943 Act.
87 Subsection (i) (1) (D) of the 1943 Act.
88 Under subsection (i) (3) of the 1943 Act.
89 The processors of meats and poultry as well as dealers in certain other farm products were exempted by administrative order which is permitted by the 1942 Act.
See note 86 supra.
90 See note 87 supra. Subsection (i) (1) (E) of the 1943 Act.
lar portion of the new law is effective only with regard to fiscal years ending after June 30, 1943. Moreover, it should be noted that it applies only to contracts directly with the renegotiating departments and does not relate to subcontracts. However, this distinction seems to be of no importance because subcontracts for the improvement to real estate, such as appear to be contemplated by this subsection of the act, are exempted by the definition of "subcontract" itself which applies only to personal property and not to realty in the sense that the Renegotiation Act intends. Real estate as exempted by the inference which arises from the definition of "subcontract" implies something in the nature of constructing rather than assembling an object and the meaning of the term "real estate" in the act is not based upon concepts which govern the local laws of fixtures.

Two questions of interpretation are presented here. The term "facility" as used in this exemption has given rise to some uncertainty as to its meaning. It is argued that the term properly interpreted embraces machinery and equipment as well as the construction of buildings. This position perhaps is founded upon the use of the word "facility" by the procurement agencies in making what are known as "facility contracts." There the term "facility" is used to mean a contract for the furnishing of machinery and equipment, or a contract for the construction of a building alone. The procurement agencies, during this war, have also used the term "facility" in referring to a particular company. But the term as used in the Renegotiation Act appears to be limited to instances involving construction work and not merely to the bringing in of finished items (machinery), or the assembly of items on the premises where the bulk of the fabrication has been completed elsewhere. The term in the context of the act is related to the words "for the construction of any building, structure, improvement, or facility" and it must be assumed that it takes its meaning from the generic standard established by the other terms associated with it. It seems quite evident that Congress intended that this exemption relate only to construction contracts which are "for the construction of buildings, structures, improvements or facilities." (Italics supplied).

The Senate Committee on Finance in reporting the Revenue Bill of 1943 stated:

91 Subsection (a) (5) of the 1943 Act.
93 Subsection (i) (1) (E) of the 1943 Act.
"Your committee bill also exempts contracts with a department which are awarded after advertisement and as a result of competitive bidding for the construction of buildings, structures, improvements, or facilities. It is believed that in the case of prices established as a result of such advertisement and competitive bidding there will be no need for further revision under renegotiation and therefore such contracts should be exempt." 94

"Your committee has added to paragraph (1) of subsection (i), as amended by the House bill, a new subparagraph (G), under which the provisions of the section are not to apply to—any contract with a Department, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility.

"The renegotiation of such contracts has been found especially troublesome in certain cases and it is the opinion of the committee that construction work has reached the stage where the freedom of new contracts from the provisions of the statute will not be prejudicial to the public interest." 95

This emphasizes the fact that Congress was considering this exemption as relating to items of construction and not to items which were already assembled before they were furnished to a contractor or which were largely prefabricated and the essential nature of the work to be done was more in the character of an assembly operation than that of actually constructing an item largely from materials which do not of necessity result in one shape or form when the materials or component parts of the object are put together. 96

The foregoing statements of the Senate Committee raise another question, however, whether advertising is a necessary adjunct to the presence of competition with regard to the award of contracts of this nature. It appears that Congress had in mind that competition with regard to these construction contracts had to be evidenced by advertising. The question then raised is just what is meant by advertising? Prior to the enactment of the First War Powers Act in 1941, 97 it was required that government contracts be awarded as a result of advertising but this requisite was generally considered to have been satisfied

95 Id. at p. 103, ¶ 9.
96 It will be noted that the treatment of this problem is closely analogous to the exemption of real estate as brought out by the definition of "subcontract" and "article" in subsections (a) (5) and (6) of the 1943 Act.
when it appeared that the contract was awarded after the opportunity
to bid had been made available to several qualified bidders. Advertising
has not been construed as necessarily requiring insertion of invitations or notice of invitations to bid on contracts in newspapers or other publications.

The War Contracts Price Adjustment Board has adopted an inter­pretation which construes the word "advertisement" to mean "published advertising or such other solicitation for bids as had opened the bidding to all probable bidders under the circumstances of the particular case. 'All probable bidders' should be deemed to include all qualified bidders who could have been reasonably expected to bid on a job of the size, character and location concerned." 98 The administrators of the act do not require that a contract have been awarded as the result of published advertising for this exemption to become operative. It also appears that there are circumstances under which only one bid is received upon which the contract is awarded and yet the requirements of this exemption will be satisfied. These instances, however, are going to be the exception rather than the rule and will be given especial attention by the board. 99

A further statutory exemption is provided by subsection (i) (1) (F) which removes from the sphere of renegotiation "any subcontract, directly or indirectly under a contract or subcontract to which this section does not apply by reason of this paragraph." The effect of this is to exempt all subcontracts of whatever tier which fall under a prime contract which is removed from the operation of renegotiation by one or more of the statutory exemptions. This subsection operates only to exempt contracts that are specifically exempted by statute and not those exempted by administrative action as is permitted under subsection (i) (4) of the 1943 Act. This puts into effect by statute what was unques-

98 Renegotiation Regulations 346.2; C.C.H. War Law Service ¶ 5346.2.
99 The interpretation of the word "advertisement" adopted by the War Contracts Price Adjustment Board on June 30, 1944 is as follows:
"RR 346.2 (1) (a) and (b)
"a. As used herein ‘advertisement’ shall be interpreted as meaning published advertising or such other solicitation for bids as had opened the bidding to all probable bidders under the circumstances of the particular case. 'All probable bidders' should be deemed to include all qualified bidders who could have been reasonably expected to bid on a job of the size, character, and location concerned.

"b. The determination, with respect to any contract of the type included under subparagraph (1) as to whether or not there was ‘advertisement’ as defined above shall be made by the Department conducting the renegotiation of such contract."

See also Renegotiation Regulations 346.2; C.C.H. War Law Service ¶ 5346.2.
tionably the proper interpretation of the 1942 Act. This exemption is made retroactive to April 28, 1942.

The board is authorized to issue regulations which interpret and apply all of these statutory exemptions with the exception of that which places charitable organizations outside the scope of renegotiation. The board is also authorized to interpret the meaning of "standard commercial article" for which administrative exemption is permissible as will soon be discussed. The board must make its interpretations for applying these exemptions "by regulation" and this has been done. The authority of the board to issue these regulations relates only to fiscal years ending after June 30, 1943. With respect to all prior fiscal years the authority of the secretaries as provided in the 1942 Act remains unaltered.

The definition of subcontract which exempts certain agreements from renegotiation has not been changed except in the respect that it expressly excludes agreements for the furnishing of office supplies. This exemption is operative for fiscal years ending after June 30, 1943. Office supplies are interpreted as not including office furniture and other non-expendable items such as typewriters, calculators and the like.

Exclusion of Profits Which Arise From An Increment In Value of Excess Inventory

Certain companies frequently purchase inventory in excess of what is necessary for fulfilling their present contracts and orders. Where such inventory is composed of items exempted by the provisions of subsection (i) (1) (B) or (C) of the 1943 Act relating to mineral and natural deposits etc. not refined or treated beyond the first form suitable

100 Speaking of the laws that existed before the changes brought about by the Revenue Act of 1943 this writer said:

"... when the prime contract itself is exempted by the statute that exemption acts as an umbrella for all subcontracts made under it and they are also exempted. Subcontracts made under prime contracts which are exempted by the discretionary acts of the secretaries are not, however, protected. From the standpoint of statutory construction this interpretation seems sound. Since the secretaries are specifically authorized to exempt both prime contracts and subcontracts, it would seem that exemptions granted by administrative order should apply only to the particular contracts to which they are given." Steadman, "Legal Aspects of Renegotiation," 42 Mich. L. Rev. 545 at 577 (1944).

101 Subsection (i) (1) (F) of the 1943 Act.
102 Subsection (i) (2) of the 1943 Act.
103 Ibid.
104 Renegotiation Regulations, 340 et. seq.
105 Subsection (a) (5) (A) of the 1943 Act.
106 Renegotiation Regulations 334.4; C.C.H. War Law Service ¶ 5334.4.
for industrial use or consists of exempted agricultural commodities removed from the scope of renegotiation, the act, for all fiscal years, operates to exclude from the determination of excessive profits any profit arising from the "increment in value of the excess inventory," which the contractor receives from renegotiable sales. The act, for all fiscal years, operates to exclude from the determination of excessive profits any profit arising from the "increment in value of the excess inventory," which the contractor receives from renegotiable sales. In other words, where an excess of inventory of these exempted categories has been purchased and held by the contractor, any profit which inures to the contractor from renegotiable contracts as the result of the increase in value of this inventory must be excluded from consideration in determining whether the company has realized excessive profits. Congress thus chose to regard the increment in value of the excess inventory as a long-term gain similar to gains arising from other long-term investments. The reasons for this stem from the fact that the contractor could have realized a profit exempt from renegotiation at any time by selling the inventory at its appreciated prices, repurchasing it at the increased cost and charging such costs against renegotiable income during the year when the excess inventory was used for the performance of renegotiable contracts. This treatment of the increment in value of such inventory does not penalize the contractor who has made purchases at a prior time and does not encourage contractors to engage in selling and repurchasing so as to create a non-renegotiable profit. This procedure, moreover, results in according substantially the same treatment to those who purchased these exempted products in excess of their requirements whether they are integrated or non-integrated producers.

Removal of the increment in value of excess inventory from consideration in renegotiation is of particular significance in the textile field where it is usually the practice to purchase in excess of current requirements. It does not appear to have the same importance, however, in the heavy industries for there the purchase of exempted products in the nature of ore, ingot, pig-iron and the like is largely restricted to quarterly requirements imposed by the War Production Board through the operation of the Controlled Materials Plan. It is also true that there is available to integrated producers a fair cost allowance where inventory is purchased below rather than at the exempt level and treated or refined by such producers beyond its non-exempt stage. This treatment is assured through other provisions of the act.

The methods for excluding such profits from consideration in re-

107 Subsection (i) (3) of the 1943 Act.
108 Ibid.
negotiation are to be in accordance with the regulations prescribed by the War Contracts Price Adjustment Board and extensive regulations with regard to this subsection of the act have been issued.\textsuperscript{109} As noted before, this portion of the statute is retroactive to April 28, 1942 and has the same effect as though it were part of the original law.

The act provides for a refund or credit to be given to contractors in those cases where renegotiation of a fiscal year ending before July 1, 1943 occurred before the enactment of the Revenue Act of 1943.\textsuperscript{110} And, insofar as the increment in value of the excess inventory was considered in arriving at the amount of excessive profits in the renegotiation of such a year, a refund will be made. This refund is available if the renegotiation was completed prior to the date of the enactment of the Revenue Act of 1943 irrespective of whether the determination is embodied in an agreement. But it is available only to the extent that it arises from renegotiable business and only insofar as it does not exceed the amount of excessive profits determined for the fiscal year concerned. Moreover, in order to obtain the refund the contractor must have filed a claim therefor with the secretary of the department conducting the renegotiation within ninety days from February 25, 1944. The time for such filing thus expired on May 25, 1944. However, the renegotiating departments with whom the claim for refund must have been made have indicated that a written statement requesting the refund, filed before the 25th of May 1944, will be considered as a timely claim. The claim may later be perfected by filing such supporting data as is necessary to demonstrate that the company is entitled to the refund. The renegotiating agencies with whom the claim is filed will prescribe the necessary regulations with regard to this matter and the agency which handled the contractor's case originally will be the one that considers such a claim.

\textit{Exemptions by Administrative Order}

The new act has vested considerable discretionary power in the War Contracts Price Adjustment Board to exempt certain types of contracts. Besides the three classes of contracts which the secretaries are permitted to exempt at their discretion by virtue of the 1942 Act,\textsuperscript{111} there have

\textsuperscript{109} Renegotiation Regulations 334.4; C.C.H. \textit{War Law Services} ¶ 5334.4.

\textsuperscript{110} Subsection (i) (3) of the 1943 Act.

\textsuperscript{111} (1) Contracts or subcontracts to be performed outside the territorial limits of the continental United States or Alaska, subsection (i) (4) (A);

(2) Contracts or subcontracts which because of their nature permit the determina-
been added three additional categories permitting administrative exemptions.

(1) Contracts and subcontracts which are for so-called "standard commercial articles," may be exempted by the board when it believes that competitive conditions existing with relation to the sale of such articles will give the Government reasonable protection against excessive prices. The War Contracts Price Adjustment Board has taken the position that it will not apply this exemption with regard to individual contracts but it will be made applicable with respect to classes and types of articles. When a contractor requests that this exemption be made operative as to him the board will consider such a request upon an industry basis rather than considering it on the basis of the individual contractor. It is the attitude of the board that, even though certain individual contractors may not be earning excessive profits from the sale of standard commercial items, nevertheless, they are more easily dealt with by clearing them with regard to a renegotiation period than by applying this exemption to contractors individually. Since this is one of the discretionary exemptions, the control of its application rests with the board.

Condition of profits with reasonable certainty when the contract price is established, subsection (i) (4) (B); and

(3) Any contract may be exempted for a specified period when its provisions are sufficient to prevent the occurrence of excessive profits, subsection (i) (4) (C). The citations are to the 1943 Act but these provisions are also to be found in the 1942 Act. Subsection (a) (7) of the 1943 Act defines "standard commercial article" as:

"(7) The term 'standard commercial article' means an article—

(A) which is identical in every material respect with an article which was manufactured and sold, and in general civilian, industrial, or commercial use prior to January 1, 1940,

(B) which is identical in every material respect with an article which is manufactured and sold, as a competitive product, by more than one manufacturer, or which is an article of the same kind and having the same use or uses as an article manufactured and sold, as a competitive product, by more than one manufacturer, and

(C) for which a maximum price has been established and is in effect under the Emergency Price Control Act of 1942, as amended, or under the Act of October 2, 1942 entitled 'An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes,' or which is sold at a price not in excess of the January 1, 1941, selling price.

"An article made in whole or in part of substitute materials but otherwise identical in every material respect with the article with which it is compared under subparagraphs (A) and (B) shall be considered as identical in every material respect with such article with which it is so compared."

As of June 15, 1944, no exemptions of this character had been made by the board on the ground that competitive conditions had not been restored.

(2) If the board is of the opinion that competitive conditions are present in the making of a contract or subcontract to such an extent that competition would be an effective element in determining the contract price, then the board may exempt such contracts or subcontracts. The attitude of the board with regard to applying this exemption is the same as in the case of exempting standard commercial articles. Exemptions are to be granted only by classes and types—industry-wise, rather than with regard to individual contractors.

(3) A revision in the law which may be of some help in the administration of renegotiation is the provision which permits the board to exempt subcontracts either individually or by group when it is not administratively possible or desirable to determine and segregate the profits that arise from such subcontracts or group of subcontracts. This authority gives the administrators of the act a means of overcoming a situation where it is impossible to make a segregation of profits if such a case should arise. The act directs the renegotiation only of those profits arising from sales to the renegotiating agencies. Should a case arise in which it was impossible to make a segregation of renegotiable and non-renegotiable profits without the authority to make the exemption which this provision of the act creates, the renegotiators might find themselves in somewhat the same position as Shylock when he was confronted with Portia's argument that he could have his pound

115 Subsection (i) (4) (E) of the 1943 Act.

116 In relation to exempting construction contracts, the War Contracts Price Adjustment Board has determined that competitive conditions which affected "the making of construction contracts and subcontracts entered into subsequent to June 30, 1943, were such as to result in effective competition with respect to the contract or subcontract price where all of the following conditions exist:

"(1) The contract or subcontract is one of the construction of buildings, structures, improvements or other similar facilities. Contracts or subcontracts for the furnishing of materials or supplies or for the lease or sale of machinery or equipment are not within the scope of this exemption. Also see paragraph 346.2 for interpretation of mandatory exemption relating to such construction and see paragraph 335.2.

"(2) The contract was entered into subsequent to June 30, 1943, and did not constitute a substitute for or a revision or extension of an existing contract entered into on or before June 30, 1943.

"(3) The work covered by the contract was substantially the same as the work for which the bids were requested.

"(4) Bids were received from two or more responsible and qualified contractors, who were independent of each other and were in actual competition with each other for the work for which bids were requested.

"(5) The contract price was not in excess of the low bid received."

117 Subsection (i) (4) (F) of the 1943 Act.
of flesh but no blood. This new exemption will permit the cutting of this administrative Gordian knot if and when it presents itself.

**Determination of Excessive Profits**

The 1943 Renegotiation Act brings about many changes with respect to determining excessive profits. Statutory standards in a more specific and extensive nature have been created, the administrators are required to follow the Treasury's position with regard to allowances and costs and deductions, carry-over and carry-back provisions are specifically not allowable, a recomputation of the amortization deduction is provided for, and integrated producers are guaranteed that material which they process from its raw state up to and beyond the point of exemption will be accorded certain cost allowances. These changes are among the most fundamental that have been made in the act.

The Establishment of Statutory Standards

One of the prime criticisms leveled at renegotiation was that the act did not establish sufficient standards or criteria which the renegotiating agencies were enjoined to follow. Excessive profits are defined under the 1942 Act as those found as a result of renegotiation to represent excessive profits. The renegotiating agencies are called upon to follow certain cost criteria in determining excessive profits for fiscal years ending before July 1, 1943, principally upon the basis of that established by chapters 1 and 2E of the Internal Revenue Code and

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118 "Portia: Tarry a little; there is something else, This bond doth give thee here no jot of blood, The words expressly are 'a pound of flesh.' Then take thy bond, take thou thy pound of flesh, But in the cutting it, if thou dost shed One drop of Christian blood, thy lands and goods Are, by the Laws of Venice confiscate Unto the state of Venice."

*SHAKESPEARE, MERCHANT OF VENICE* iv, 1, 319-326.

119 "The existing law has as its basic purpose the prevention of exorbitant and unconscionable costs of materials for war. To accomplish this purpose, the act not only gave authority to the departments charged with renegotiation to redetermine and refix prices, but also to recapture excessive profits on amounts already paid by the Government. This last power was an innovation in our system of government. In effect, it delegated to the departments concerned the power to determine excessive profits according to their discretion. The existing law provided no standards for this purpose. It defined excessive profits as 'any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits.'" S. Rep. No. 627 on H.R. 3687, 78th Cong., 1st sess., December 22, 1943 (Committee on Finance).

120 Subsection (a) (4) of the 1942 Act.
are not permitted to allow any unreasonable salaries, bonuses or costs. The 1943 Act, however, undertakes to create extensive statutory standards by which excessive profits are to be found. In making such a determination these factors must be considered:

"(i) Efficiency of contractor, with particular regard to attainment of quantity and quality production, reduction of costs and economy in the use of materials, facilities, and manpower;

(ii) reasonableness of costs and profits, with particular regard to volume of production, normal pre-war earnings, and comparison of war and peacetime products;

(iii) amount and source of public and private capital employed and net worth;

(iv) extent of risk assumed, including the risk incident to reasonable pricing policies;

(v) nature and extent of contribution to the war effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance;

(vi) character of business, including complexity of manufacturing technique, character and extent of subcontracting, and rate of turnover;

(vii) such other factors the consideration of which the public interest and fair and equitable dealing may require, which factors shall be published in the regulations of the Board from time to time as adopted." ¹²¹

Profits that arise out of renegotiable contracts are defined as "the excess of the amount received or accrued under such contracts and subcontracts over the costs paid or incurred with respect thereto." ¹²² Other standards established by the 1943 Act are to be found in those sections describing the methods by which costs, allowances and deductions are to be ascertained as well as other sections of the act, especially those relating to the exemption of contracts and subcontracts from the effect of renegotiation. The 1942 Act indicates clearly the policy against the creation and retention of excessive profits and the 1943 Act does not change that policy. It declares, however, more definite and certain gauges which are to be followed by the administrators of the law in measuring excessive profits.

¹²¹ Subsection (a) (4) (A) of the 1943 Act.
¹²² Subsection (a) (4) (B) of the 1943 Act.

"The definition of 'excessive profits' in the existing law illustrates what I mean. It is rather remarkable. It reads like this:

'The term "excessive profits" means any amount of a contract or subcontract
Allowable Costs, Exclusions and Deductions

The 1943 Act requires that the contractor's regularly employed accounting system be looked to for a reflection of his costs in the renegotiation of fiscal years ending after June 30, 1943. This is a change from the 1942 Act which is silent on this point. The policy of the renegotiating agencies, nonetheless, was to look to the contractor's books where they adequately indicated his costs. If the method of cost accounting which the contractor uses does not properly reflect his costs in the opinion of the board, or of the Tax Court of the United States upon a redetermination of excessive profits, costs shall then be determined in accordance with the method determined by the board or the Tax Court, as the case may be.

The board and the Tax Court are both authorized and directed to disallow any unreasonable items of cost attributable to any contract or subcontract under consideration, as is true also with the secretary and the Tax Court in the case of 1942 fiscal years.

Another significant alteration of the act is that which requires the

price which is found as a result of the renegotiation to represent excessive profits.

"Really a work of art by the Congress for which we are all to blame. The absence of any standard in the present law for the determination of excessive profits leaves the American system of free enterprise completely at the mercy of the social views of whoever happens to have the job of determining excessive profits.

"We try on pages 101 and 102 of the bill to give a definition of 'excessive profits,' and I think you will find a fairly satisfactory definition. Twenty-five men on the Ways and Means Committee, who feel that they are as good as the average man and woman of the House, have worked very assiduously, sometimes very heatedly, over this whole subject. We went to grips with each other without nearly the unanimity that appears on this floor now. But we tried to define 'excessive profits' in a legal manner. We prescribe the factors on page 102 which must be taken into consideration in the determination of excessive profits. The standards are necessarily general, for it is obvious that a dollar amount or value cannot be ascribed to any one factor, any more than in the purchase of a horse can so many dollars be ascribed by the purchaser to soundness, so many to wind, and so many to a straight tail. It is impossible to fix exact standards because of varied situations and circumstances under renegotiation. All of the factors prescribed; however, must be taken into consideration. Furthermore, when the Board makes a determination of excessive profits it must, at the request of the contractor or subcontractor, furnish him with a statement of the determination, of the facts used as a basis therefor, and of the reasons for the determination of the particular amount of excessive profits found. Thus the contractor will be apprised not only of the facts used by the Board in making its determination, but also of the reasoning which on the basis of such facts compelled the conclusion which the Board reached." Rep. Disney, Oklahoma, 89 Cong. Rec. No. 185, dated November 30, 1943, p. 10249.

123 Subsection (a) (4) (B) of the 1943 Act.
124 Ibid.
125 Ibid.
126 Subsection (d) of the 1942 Act.
allowance or disallowance of exclusions and deductions as provided in chapters 1 and 2E of the Internal Revenue Code (with the exception of taxes measured by income) "as estimated to be allowable." Such deductions are to be allowed, of course, only to the extent that they are allocable to renegotiable business, but to this extent they must be recognized as estimated to be allowable by these sections of the Internal Revenue Code. It is apparent that it would not be possible effectively to administer renegotiation if the allowance of certain costs, exclusions or deductions had to await not only the determination of the Commissioner of Internal Revenue but also that of the courts. Therefore, the board is permitted to make these allowances as it "estimates" them to be allowable under the Internal Revenue Code.

In estimating allowable costs and deductions as provided in chapters 1 and 2E of the Internal Revenue Code taxes measured by income are to be excluded as costs. However, when excessive profits are determined an allowance for all taxes except federal taxes attributable to that part of the contractor’s renegotiable profits which are not excessive, must be made under the provisions of the 1943 Act. The House Committee on Ways & Means in its report on the Revenue Bill of 1943 exemplifies the operation of this part of the act by this illustration:

"... For example, if the amount due on a contract is $1,000 and the cost, exclusive of State or Federal income tax, $800, the profit would be $200. Suppose it should be determined that of the $200 profit $100 was excessive, and $100 not excessive. In determining the amount of excessive profit to be eliminated it is provided that proper adjustment shall be made for the State income tax excluded as an item of cost which is attributable to the $100 not excessive. If in this case the State income tax on the $100 of fair profit is $10, then this $10 attributable to the $100 of fair profit would be credited against the $100 determined to be excessive profit reducing the amount to be eliminated to $90."

Subsection (a) (4) (B) of the 1943 Act.

Subsection (a) (4) (B) of the 1943 Act.


The Senate Committee on Finance in its report on the Revenue Bill of 1943, S. Rep. No. 627 on H. R. 3687, 78th Cong., 1st sess., December 22, 1943, pp. 104-105 gives this example:

"State income taxes likewise are disallowed as an item of cost but the bill provides for a proper adjustment, in determining the amount of excessive profits to be eliminated, for such taxes attributable to the nonexcessive portion of profits. For example, if the amount due on a contract is $1,000 and the cost is $800, the profit before
The effect of this section then is to make state taxes which are measured by income allowable items of cost in the proportion to which they are related to the contractor's non-excessive renegotiable income. This does not result in the Federal Government's paying state income taxes. The procedure followed is that the amount of excessive profits is first determined and then the allocation of the amount of state income taxes is made as between the excessive and non-excessive portions of the contractor's profits. Federal income and excess profits taxes are not allowable as deductions and exclusions from income for the purposes of renegotiation.\(^{130}\) This adjustment for the payment of state taxes applies only with respect to fiscal years ending after June 30, 1943.

**Aggregation of Contracts—Renegotiation by Fiscal Years**

The 1942 Act permits the renegotiation of individual contracts.\(^{131}\) With regard to fiscal years ending after June 30, 1943, however, individual contract renegotiation is not possible except upon request of the contractor or subcontractor and agreement by the War Contracts Board. And it must proceed with regard to the aggregate amounts received or accrued under renegotiable contracts or subcontracts during a fiscal year, period or portion thereof such as may be subject to the act.\(^{132}\)

**Carry-over and Carry-back**

Sections 23(s) and 122 of the Internal Revenue Code permit a carry-over of net operating losses for the first and second preceding taxable years as well as a carry-back of operating losses that occur in certain subsequent years. Under the Renegotiation Act as it existed prior to the amendments made by the Revenue Act of 1943, a loss that was carried over was recognized where it was directly related and adjustment for such tax is $200. Suppose that of the $200 profit, $90 is considered excessive before adjustment for the State tax. If in such case the State income tax on the remaining $110 is $11, then the $11 is to be applied against the $90, reducing to $79 the amount of excessive profit to be eliminated.\(^{133}\)

\(^{130}\) The discussion here is related to the application of this adjustment as provided in subsection (a) (4) (B) of the 1943 Act where the state tax is imposed on a flat rate basis. Adjustment for graduated state taxes differs somewhat and follows the procedure set forth in Renegotiation Regulations 389.3; C.C.H. WAR LAw SERVICE ¶ 5389.3.

\(^{131}\) Subsection (c) (1) of the 1942 Act.

\(^{132}\) Subsection (c) (1) of the 1943 Act.

Inasmuch as renegotiation may be extended beyond December 31, 1944 for any period not to exceed six months, it is possible that there may be renegotiation of portions of fiscal years. This possibility has been adverted to through subsection (c) (6) of the 1943 Act.
attributable to the contracts which were the subject of the renegotiation. Carry-backs were not recognized, however, because it would be necessary to reopen a renegotiation settlement in order to give them effect. Now, relating back to April 28, 1942 the allowance of any carry-over and carry-back as an item of cost is specifically prohibited.\textsuperscript{185}

\textit{Amortization Deductions}

The amortization deductions authorized by section 124 of the Internal Revenue Code with regard to war facilities permitting the cost of such facilities to be amortized over a sixty-month period for purposes of taxation are proper deductions from income in renegotiation to the extent that they are allocable to renegotiable sales. Section 124(d) of the Internal Revenue Code permits an acceleration of the amortization period where the war emergency is declared at an end prior to the expiration of the sixty-month period or upon the issuance of certificates of non-necessity.\textsuperscript{184} The acceleration of the period, however, raises the problem as to what effect the recomputation of the amortization resulting from such acceleration will be given in renegotiation.

If the renegotiation has not been completed for a fiscal year affected by the recomputation of the amortization deduction the recomputed amortization will be given effect as an allowable cost to the extent attributable to renegotiable business in the renegotiation of that year.\textsuperscript{185} Where the renegotiation has been completed, however, how is the recomputation of the amortization to be recognized? As has been pointed out, it was not considered possible to reopen agreements for 1942 fiscal years so as to recognize this recomputation. Subsection (a)(4)(D) of the 1943 Act, however, by provisions retroactive to April 28, 1942 establishes a means for providing a refund of excessive profits eliminated through the renegotiation of a prior year insofar as the recomputation under section 124(d) is in excess of the deductions that have been allowed in such renegotiation. Where there is an acceleration of the amortization period and the recomputation flowing

\textsuperscript{185} Subsection (a) (4) (b) of the 1943 Act.

\textsuperscript{184} The regulations for the issuance of certificates of non-necessity as provided by section 124 of the Internal Revenue Code have not yet been promulgated. Therefore, none of these certificates have been issued. It is anticipated, however, that the regulations governing the issuance of these certificates which will permit an acceleration of the sixty-month amortization period, under circumstances where the facilities are no longer needed in the war effort, will soon be forthcoming.

\textsuperscript{185} Subsection (a) (4) (C) of the 1943 Act.
therefrom is made after the renegotiation of a given year, the con-
tractor receives no allowance in renegotiation for the additional amorti-
ization accruing to his benefit for federal income and excess profits tax
purposes. And the fact that at the time renegotiation is being conducted
the recomputation of the amortization deduction may not have been
made, is not considered as a ground for postponing the determination
of excessive profits and will not stay the payment of any amount found
to be excessive.\textsuperscript{186} But after the recomputation of the amortization
deduction by the Bureau of Internal Revenue has been completed a
refund becomes available to the contractor from the department that
has made the renegotiation. This will be determined by computing the
"gross renegotiation rebate"\textsuperscript{187} which is that portion of the additional
amortization deduction permitted through the recomputation under
section 124(d) allocable to renegotiable sales for each prior renegoti-
tiated year. The amount of the gross renegotiation rebate, however,
cannot be recognized in an amount greater than the excessive profits
eliminated for each such year less the amount of the contractor's federal
income and excess profits tax benefit from renegotiation for the rene-
gotiated year. The tax benefit will be the amount by which the con-
tractor's taxes for the renegotiated year were decreased either through
the omission from gross income of that part of the excessive profits
which is not in excess of, but may be equal to, the sum of the additional
amortization deduction or by the application of section 3806 of the
Internal Revenue Code with reference to this amount.\textsuperscript{188} The amount
yielded by this computation is the sum which will be refunded. It is
the "net renegotiation rebate" for the renegotiated year and will be
repaid to the contractor by the United States, but without interest.\textsuperscript{189}

Here is an example showing the calculation of the net renegotiation
rebate:

Assume that a contractor had been issued certificates of necessity
to cover emergency facilities costing $1,000,000. Of these facilities
$750,000 have been used exclusively in the performance of rene-
gotiable business during the fiscal year under consideration and the
remainder, $250,000, has been used in the performance of non-rene-
gotiable contracts. During the fiscal year considered the contractor
refunded $600,000 as excessive profits. For that year the contractor
took a $200,000 amortization deduction in his tax return. Following

\textsuperscript{186} Subsection (a) (4) (C) of the 1943 Act.
\textsuperscript{187} Subsection (a) (4) (D) of the 1943 Act.
\textsuperscript{188} Ibid. Under chapters 1, 2A, 2B, 2D, and 2E of the Internal Revenue Code.
\textsuperscript{189} Subsection (a) (4) (D) of the 1943 Act.
the close of the renegotiation for this period the amortization period was terminated and a recomputation was made for federal income and excess profits tax purposes which raised the amount allowable for federal taxes to $500,000 in this one year. Under these assumed circumstances subsection (a)(4)(D) would operate in this way:

Of the $200,000 which the contractor took as an amortization deduction on his tax return, seventy-five per cent is attributable to renegotiable business and this amount, $150,000, was allowed in renegotiation. The recomputed deduction as provided in section 124(d) for this year is $500,000 and since seventy-five per cent of these facilities were used in renegotiable business, of this additional amortization deduction, $375,000 is allocable to renegotiable business. $150,000 amortization deduction was allowed in the original renegotiation. The excess over the amortization deduction originally allowed for renegotiation is $225,000. Inasmuch as the contractor cannot be allowed as a refund here an amount greater than the amount of the additional amortization deductions which were allowed for renegotiation in the year under consideration less the tax savings which the contractor realized through the omission from gross income of excessive profits equaling the amount of the additional amortization deductions, it is necessary to compute the tax on the amount of the excess over the amortization deduction originally allowed. Assuming that the contractor in this illustration is in the eighty per cent bracket for federal income and excess profits tax purposes, the tax on this excess amount would be $180,000. Therefore, the net rebate as the result of the recomputation to be repaid to the contractor is $45,000.

The act directs that the board shall issue regulations for determining the allocation of the additional amortization deduction to the renegotiated year. These have not yet been issued, however, inasmuch as the two conditions, the happening of either of which would permit the acceleration of the amortization period and a recomputation of the amortization, have not transpired. The emergency as defined in section 124 has not ended and the regulations for the issuance of certificates of non-necessity have not been promulgated.

Allowable Costs in the Case of Certain Producers

Under the administration of renegotiation prior to the Revenue Act of 1943 it was the policy of the renegotiating departments to accord contractors and subcontractors who processed the mineral and natural

140 Ibid.
deposits and raw materials that were covered by the act, a cost allowance which was generally equivalent to an amount which the contractor would have realized had he sold the product in the form which it had in the last stage of processing before becoming non-exempt. The object of this costing method was to accord the same treatment to integrated and non-integrated producers. This procedure worked so satisfactorily that Congress made it a part of the Renegotiation Act retroactive to April 28, 1942 and extended this cost allowance to a contractor or subcontractor "who produces or acquires an agricultural product and processes, refines, or treats such a product to and beyond the first form or state in which it is customarily sold or in which it has an established market." This retroactive feature, in the light of the prior practice of the renegotiating departments, will have no new effect except that this cost allowance also applies in the case of agricultural commodities; but this procedure is now a part of the statute rather than being operative only through administrative regulation.

Conversion to War Production

Since many contractors have made extensive plant rearrangement in converting their facilities to war production, the problem of the ex-
tent to which the costs of such conversion will be allowed in renegotiation is of considerable interest. The answer to this question lies in the fact that the agencies must follow the rulings of the Bureau of Internal Revenue with regard to this matter, at least "as estimated" to be allowable.\textsuperscript{144} The attitude of the bureau presently is that, where such conversion and rearrangement does not represent a permanent addition to the contractor's plant, such costs are allowable for the purposes of federal income and excess profits taxes. Since this is the case they will also be allowed in renegotiation insofar as allocable to renegotiable sales. One of the best examples where costs are most likely to be allowed as not constituting permanent additions, is in the case of the rearrangement of machinery and equipment; and certain partitions placed in a company's plant which are clearly and purely of a temporary nature may also be allowed where related to renegotiable business.\textsuperscript{145}

**Recapture of Excessive Profits**

Under the 1943 Act where the board or the Tax Court makes a determination of excessive profits, the board is directed to instruct the secretary of the department to bring about the elimination of any amount to be recovered.\textsuperscript{146} The methods under the 1943 Act do not differ substantially from those previously permitted.\textsuperscript{147} A provision of importance in the 1943 Act, however, is one which provides that "each contractor and subcontractor is hereby indemnified by the United States against all claims by any subcontractor on account of amounts withheld from such subcontractor pursuant to this paragraph."\textsuperscript{148} This clause was designed to implement the recovery of amounts due under subcontracts between the contractor or a subcontractor and another contractor. Where, in relation to fiscal years ending after June 30, 1943, a contractor or subcontractor is directed to withhold amounts which he owes to another subcontractor, the contractor who withholds amounts otherwise due and owing to the subcontractor will now be indemnified against any action which the subcontractor might bring against him for such sums withheld.

There are certain methods of payment available which contractors may find useful. In paying excessive profits, aside from payment in

\textsuperscript{144} Subsection (a) (4) (B) of the 1943 Act.

\textsuperscript{145} Renegotiation Regulations 384; C.C.H. War Law Service \$ 5384.

\textsuperscript{146} Subsection (c) (2) of the 1943 Act.

\textsuperscript{147} Cf. subsection (c) (2) of the 1943 Act.

\textsuperscript{148} Subsection (c) (2) of the 1943 Act.
The contractor may issue a credit memorandum to one of the renegotiating departments to be applicable against specified existing prime contracts where the sum of the amounts remaining unpaid thereon is not in excess of the amount to be credited.\textsuperscript{149} Tax anticipation notes are not an acceptable means of payment. The Treasury Department, nevertheless, has authorized the redemption currently of Series B or Series C tax notes in those instances where the amounts received from the redemption of the notes are to be used in the liquidation of the renegotiation obligation.\textsuperscript{150}

**The Tax Effect of Renegotiation**

The Revenue Act of 1943 amends section 3806 of the Internal Revenue Code so as to extend the tax credit in renegotiation, which this section provides, to individuals under the circumstances created by the income tax computation features of the Current Tax Payment Act of 1943.\textsuperscript{151} It will be remembered that, because of the forgiveness features of that act, there was no tax credit available for individuals with regard to the renegotiation and elimination of excessive profits for the 1942 taxable year.\textsuperscript{152} As between the taxable years 1942 and 1943 there is only one tax liability since the tax is determined by a comparison of the incomes, 1942 and 1943, and the tax is then paid upon the larger of the two. Because of these facts the only tax credit available to an individual as a result of elimination of excessive profits through renegotiation for the taxable years 1942 and 1943 is with respect to the taxable year 1943. The tax credit which becomes available by virtue of the revisions in section 3806 which are made retroactive to the date of the original enactment of this section, October 21, 1942, is the amount by which the total tax for 1943 is decreased as a result of the elimination of excessive profits received or accrued to the taxpayer in 1942 or 1943. Thus, because the Current Tax Payment Act of 1943 makes provisions for a computation of the tax through a comparison of the income for the taxable year 1942 and the income for the taxable year 1943 with a forgiveness of seventy-five per cent

\textsuperscript{149} Renegotiation Regulations 422.5; C.C.H. War Law Service \& 5422.5.

\textsuperscript{150} Renegotiation Regulations 422.6; C.C.H. War Law Service \& 5422.6.

\textsuperscript{151} Section 701 (c) of the Revenue Act of 1943.

\textsuperscript{152} For a discussion of the tax effect in renegotiation in relation to corporations and to individuals before the further extension of tax credit provided by the amendment to § 3806 by § 701 (c) of the Revenue Act of 1943, see Steadman, "Legal Aspects of Renegotiation," 42 Mich. L. Rev. 545 at 586 (1944).
of the lesser of the two, the larger of either an individual's tax liability for the year 1943 as reflected on the 1943 return or the total of his payments for his 1942 and 1943 taxes will be the amount of an individual's total tax liability for the taxable year 1943 which will be diminished through the elimination of excessive profits in renegotiation.

In those cases then, where the renegotiation of an individual is completed after the filing of the tax return for the taxable year 1943, the credit to be granted by virtue of section 3806(b) will be an amount equal to the decrease in the tax for the taxable year 1943 resulting from the elimination of 1942's excessive profits from 1942 income.\footnote{158}

In many cases renegotiation of an individual for the year 1942 was completed before he had filed his 1943 tax return. In some of these instances taxpayers estimated that they had already paid, with regard to their 1942 tax, more than the tax for the taxable year 1943 was likely to be. A contract clause for inclusion in renegotiation agreements was authorized to cover these situations and under this clause the individual was given a credit in the amount of the estimated overpayment of his 1943 tax. An adjustment of the credit was then to be made when the 1943 tax return was filed so that the credit ultimately allowed would equal the amount actually allowable. The amendments to section 3806 contained in the Revenue Act of 1943 provided a statutory recognition of the credits permitted under these contracts.\footnote{154} The principles that are enunciated here are applicable to partnerships as well as individuals. Partnerships, however, file only information returns and federal income tax is imposed with regard to the individual incomes of the partners. Thus they receive separate credits, the partnership itself being entitled to the aggregate of these credits provided for individuals under section 3806.

The relation of renegotiation and state taxation came to the attention of Congress while the Revenue Act of 1943 was being considered.\footnote{155} There is little or no uniformity of treatment accorded renegotiation refunds by the various states in the matter of allowing credits for purposes of state income taxation. Where a contractor's profits are reduced through a renegotiation which follows the payment of state income taxes, some states allow refunds, some do not and still others

\footnote{158 For a valuable discussion on the relationship of renegotiation and taxation see Watts, "Recognition and Federal Taxation," 10 LAW and CONTEMP. PROB. 341 (1943).}  
\footnote{154 Section 701 (c) of the Revenue Act of 1943.}  
\footnote{155 S. Rep. No. 627 on H.R. 3687, 78th Cong., 1st sess., December 22, 1943, p. 104 (Committee on Finance).}
give a limited effect to this reduction of income. As renegotiation is conducted with relation to fiscal years ending before July 1, 1943, a contractor is permitted a credit or deduction for whatever tax he was required to pay under the state tax law which he could not recover. Since the states do not accord a uniform treatment to renegotiation and certainly there is no uniformity with regard to state taxes measured by income, the result is that the states are not treated alike through this renegotiation procedure. In those cases where renegotiation is conducted with a contractor who is subject to the tax laws of a state which does not allow refunds for excessive profits eliminated in renegotiation, the Federal Government has assumed the burden, whereas those states that do allow a refund have had to carry the load and have suffered diminished incomes. When the amendments to renegotiation by the Revenue Act of 1943 were being considered, the National Association of Tax Administrators sought to have included a provision that every contractor would be allowed on renegotiation a credit for state income taxes as computed in accordance with the applicable state laws without adjustment for any excessive profits paid to the Federal Government after the end of the period which forms the basis for determining the contractor’s state taxes. The simple result of this is that the state would be permitted to ignore renegotiation after the end of any given taxable year.

Although the primary consideration with relation to this problem is the state income tax, franchise taxes, as well as capital stocks and gross receipts taxes, are also concerned. For the law to have been amended so as to permit the contractor’s state income taxes to be wholly recognized as an item of cost in renegotiation would cause an assumption of state income taxes by the Federal Government in the instance of every company that was renegotiated. Therefore, in amending the Renegotiation Act, Congress directed that state income taxes be disallowed as an item of cost.\textsuperscript{156} However, as already pointed out in a prior discussion of this matter, in determining the existence of excessive profits, an adjustment is to be made for the amount of such “taxes measured by income” as are attributable to the non-excessive part of the contractor’s profits. The effect of this is to charge as a cost the state taxes on the non-excessive portion of the contractor’s profits arising from renegotiable business against the profits that have been determined to be excessive.\textsuperscript{157} The Federal Government then will

\textsuperscript{156} Subsection (a) (4) (B) of the 1943 Act.

\textsuperscript{157} Subsection (a) (4) (B) of the 1943 Act.
uniformly bear the state income tax because of this credit arrangement with regard to the non-excessive portion of the contractor's renegotiable profits for all fiscal years ending after June 30, 1943, irrespective of whether the state permits a credit for profits recaptured in renegotiation or not. This is calculated to make uniform the treatment of state income tax laws in renegotiation and to encourage the states not to tax excessive profits. In dealing with the effect which state income taxes are to be accorded in renegotiation it is important to take into account the recent ruling of the War Contracts Price Adjustment Board which significantly interprets the phrase "taxes measured by income" found in subsection (a)(4)(B) of the 1943 Act to mean net income taxes and not gross receipts or gross income taxes as applied to state and local taxation.

**REPRICING OF WAR CONTRACTS**

Closely related to renegotiation is the repricing of war contracts. The Revenue Act of 1943 separated from renegotiation that feature of the 1942 Act which permits the refixing of prices. This power was taken out of the Renegotiation Act and conferred upon the procurement agencies through section 801 of the Revenue Act of 1943.

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158 Subsection (a) (3) of the 1942 Act.

The reasons for this repricing section and the shifting of the power to fix contract prices from renegotiation to the Repricing of War Contracts Act is set forth in the Committee Report, Revenue Bill 1943 in S. Rep. No. 627 on H.R. 3687, 78th Cong., 1st sess., December 22, 1943, pp. 37-38 (Committee on Finance):

"A new title is inserted as to repricing. Recapture of past profits does not wholly solve the problem of adequate profit control. It is even more important to prevent the recurrence of excessive profits by adjusting prices to a fair and reasonable basis for the future.

"Such reductions of prices for future deliveries are vital in the interest of efficiency and inflation control as well as profit control. Taxes, flat profit limitations or other methods of profit recapture, reach only what is left after all payments, costs, and expenses of the producer have been met. For this reason they may tend to foster wasteful or unnecessary expenditures and even at best can do little to encourage reductions in costs. But in the war program control of costs is as important as the control of profits. With shortages of materials and labor, all producers must be encouraged to operate at their highest efficiency in order to obtain maximum production of war materials from available resources. The reduction of prices to a sound basis is one of the best methods to induce contractors to maintain efficiency. This pressure on prices of war materials tends to prevent waste of labor or materials, and unnecessary expenditures which contribute to inflation.

"The present renegotiation statute directs the departments to renegotiate contract and subcontract prices to eliminate excessive profits likely to be realized, and empowers the department to reduce such prices under the statute. The House bill confers similar
Congress had apparently come to the decision that in contracting for war commodities the procuring agencies of the Government should place emphasis upon a greater conciseness in pricing. It was believed, moreover, that, while the procurement departments had lacked the information permitting them to conduct close pricing in the early stages of the war, this is no longer true and adequate information is or ought to be available upon which fair contract prices can be established at the time the contract is made.\textsuperscript{100} It was therefore determined to confer upon the departments conducting war procurement the authority to reprice contracts whenever the head of such department considers the price being charged by a contractor or subcontractor to be unreasonable.

authority on the departments. Under it the Secretary is authorized to refix prices by agreement or order subject to appeal to the courts.

"In the interest of clarity your committee proposes that the repricing authority be separated entirely from the renegotiation statute. The methods and considerations appropriate to the repricing power are different from those applicable to renegotiation on an over-all basis for the purpose of recapture. Actually, the authority to reprice is more analogous to the power to place compulsory orders contained in Section 9 of the Selective Training and Service Act of 1940.

"Accordingly, your committee has amended the House bill and the existing law to place the authority of the departments to adjust prices in a separate title, section 801, of your committee bill. Under it the Secretary of a department is given full power to adjust prices for articles and services supplied by contractors with his department or subcontractors thereunder. If this cannot be done by agreement the Secretary may do so by order. The contractor is protected, however, by an express right to sue the United States to obtain fair and just compensation for the articles or services supplied. The department will pay to the contractor the full amount of the price fixed by an order and, if the contractor thinks the price thus fixed unfair, he may bring suit against the Government to recover the difference in the amount paid and the amount which he believes should have been paid. Any new price fixed under this section applies only to deliveries after the date of the order. Thus, these price adjustments are prospective only and do not involve recapture. Consequently this authority will not overlap the over-all renegotiation for the purpose of recapture of past profits." War Department Procurement Regulations, § 1270 et seq., delineate the Army's procedure with regard to the utilization of this section 801 of the Revenue Act of 1943.

\textsuperscript{100} S. Rep. No. 627 on H.R. 3687, 78th Cong., 1st sess., December 22, 1943, p. 32 (Committee on Finance):

"... Furthermore, it [renegotiation] was a recognition that the departments were unable in contracts for procurement of these materials to fix fair and reasonable prices. To a great extent this was difficult when we first entered the war, particularly with respect to new designs and demands for increased volume after contracts had been made. However, the statute included all materials and did not make provision that, when sufficient procurement experience had been gained, the responsibility for unreasonable costs should be put where it properly belongs, that is, in the procurement function of the departments. It is only through careful and proper procurement that it is possible to prevent payment of excessive prices, for costs once paid are difficult of recovery through a consideration of the profits of the particular individual, which bear little relation to what should have been the fair price of an item."
Congress was also of the opinion that the repricing of contracts and recapture of excessive profits were not essentially of the same character and ought to be handled differently. Hence the Repricing of War Contracts Act.\textsuperscript{161} Under this act, when the secretary or department head decides that a contract price is unfair or unreasonable, he may require the person furnishing the article or service to reduce the prices and furnish such things at prices which the department head considers to be reasonable.\textsuperscript{162} Thereafter, if the contractor is not satisfied with the price which has been specified by the secretary, he may bring an action in the Court of Claims for the difference between the amount fixed for payment and what he believes to be a fair price.\textsuperscript{163} However, if the contractor sues in the Court of Claims and it is there decided that the amount awarded by the secretary is more than a fair price, the contractor then must pay to the United States the difference between the price determined by the court and the price set by the secretary. The contractor's taking his action to the Court of Claims does not operate to stay the secretary's order.\textsuperscript{164} Any action which the contractor decides to file with the Court of Claims must be within six months after the secretary's order refixing the price or within six months after the period during which the stated price is to remain in effect, whichever is the later date. If the contractor should refuse to perform the order at the price stipulated by the secretary then the Government can take over his plant under section 9 of the Selective Training and Service Act of 1940 as amended and have the work performed.\textsuperscript{165}

Every purchase order, agreement or contract which is for the making or furnishing of any article or service of any kind to any of the renegotiating agencies of the Government\textsuperscript{166} made thirty days or more after the effective date of the act\textsuperscript{167} is deemed to contain a provision by which the persons furnishing such services or articles agree to these repricing provisions.\textsuperscript{168} Section 801 of the Revenue Act of 1943 has no application to any contract or subcontract made after the termination of hostilities, a date to be established through a proclamation of the Presi-

\textsuperscript{161} Note 159 supra.
\textsuperscript{162} Subsection 801 (b) of the Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d sess., enacted February 25, 1944.
\textsuperscript{163} Subsection (c) of § 801 of the Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d sess., enacted February 25, 1944.
\textsuperscript{164} Ibid.
\textsuperscript{165} Subsection (d) of § 801 of the Revenue Act of 1943.
\textsuperscript{166} As stated in subsection (a) (1) of the 1943 Act.
\textsuperscript{167} February 25, 1944.
\textsuperscript{168} Subsection (f) of § 801 to the Revenue Act of 1943.
dent or a concurrent resolution of both Houses of Congress, whichever is the earlier.\textsuperscript{169} The Repricing Act itself becomes effective from the date of its enactment, February 25, 1944.\textsuperscript{170}

Section 801 does not clearly indicate whether the secretary's order fixing the price may be made applicable to units of contracts already delivered. The act compels the furnishing of goods or services at the price fixed by the secretary "after the effective date of the order."\textsuperscript{171} This phrase is unfortunate in that it is open to the interpretation that the secretary may establish "the effective date of the order" as one prior to the making of the order. Reports of both the Senate Committee on Finance and the House Committee on Ways & Means serve to clarify this point.

Regarding the Repricing Act, the report of the House Ways & Means Committee says:

"... If no agreement is reached, the Secretary may by order fix the price which he determines to be fair for the performance under the contract or subcontract \textit{after the date of the order}..."\textsuperscript{172}

The Senate Committee on Finance said this:

"... Any new price fixed under this section applies only to deliveries after the date of the order. Thus, these price adjustments are prospective only and do not involve recapture. Consequently this authority will not overlap over-all renegotiation for the purpose of recapture of past profits."\textsuperscript{173}

These statements make it abundantly apparent that the repricing of war contracts section does not confer upon the departments the authority to make price fixing orders other than prospectively. In separating renegotiation and repricing it was believed that the repricing powers are substantially different from those regulatory powers established through renegotiation on an overall basis for the purpose of recapturing excessive profits. Congress believed that the authority to reprice was more analogous to the power to place compulsory orders as contained in section 9 of the Selective Training and Service Act of 1940\textsuperscript{174} than

\textsuperscript{169} Subsection 802 (b) of the Revenue Act of 1943. Noteworthy is the difference between the cutoff dates in the Renegotiation and the Repricing Acts.
\textsuperscript{170} Subsection 802 (a) of the Revenue Act of 1943.
\textsuperscript{171} Subsection 801 (b) of the Revenue Act of 1943.
\textsuperscript{172} H. Rep. No. 871 on H.R. 3687, 78th Cong., 1st sess., November 18, 1943, p. 84 (Committee on Ways and Means). (Italics supplied).
\textsuperscript{174} Act of September 16, 1940, 54 Stat. L. 885.
it is to renegotiation. There is certainly much logic to this position but this statutory rearrangement is certainly not revolutionary. And the power to place compulsory orders existed prior to renegotiation and repricing under the Selective Training and Service Act. The repricing authority has merely been taken from the Renegotiation Act and placed in a separate statute. Repricing is more in the nature of a condemnation award than in the nature of recapture. Its basis is one of fair and just compensation rather than in determination of what an unfair profit may be. Actually the repricing section introduces no new theory to American law and is in line with previous wartime enactments.

The Repricing of War Contracts Act should prove a very effective instrument in procurement. If properly employed it can go far to make renegotiation and recapture of excessive profits unnecessary by removing the opportunity for the making of such profits through close contract pricing.

RENegotiation AND ADJUSTMENT OF PATENT ROYALTIES

The Royalty Adjustment Act, Public Law 768, provides a means for reducing prospectively the amounts to be paid in royalties for the use of inventions: This statute directs the secretary or head of a department who has ordered the manufacture, use, sale or other disposition of inventions for the United States which involve the payment of royalties, to reduce the amount of any royalties being paid which he believes are unreasonable or excessive. In order to bring about a royalty adjustment the secretary of the department concerned is to proceed in this way. He is first to give a notice to the licensor and licensee that he believes the royalties are unreasonable. Following that notice the act empowers him to fix the royalties at amounts which he determines are fair and just. The licensee or licensor has a right to a

175 See note 159 supra.
177 BUSINESS WEEK, No. 773, p. 7 (June 24, 1944).

"Several top procurement officials predict that the War Dept. will not ask President Roosevelt to use his authority to extend renegotiation of contracts beyond the Jan. 1, 1945, cutoff date.

"The Army is fairly well satisfied with the results of the close-pricing policy it adopted when the renegotiation law was overhauled early this year (BW-Jan. 29 '44, p. 5). It also relies on its repricing powers which were separated from renegotiation at that time. Repricing of undelivered goods—as distinct from renegotiation of prices on completed work—is not subject to the cutoff date.

"Some contractors, after seeing how the new policy works, have decided that they liked the old system better."
hearing but after the effective date of the notice the licensee is not permitted to pay the licensor any sum in excess of the established amount. A licensor dissatisfied with the amount of royalties established by the department head is permitted access to the Court of Claims for the recovery of any sums such as will constitute fair and just compensation for the manufacture, use or sale of the licensed invention “taking into account the conditions of wartime production.”

This act is purely a wartime measure, which is to continue in force for the period of the war and six months thereafter. Its purpose is to reduce the amount of royalties in cases where they are unreasonable under the circumstances of wartime procurement. The essence of the situation with which the Royalty Adjustment Act seeks to cope is found in this statement:

“Many license contracts provide for a percentage royalty which was predicated upon commercial or peacetime Army production. Their makers never visualized the situation which now exists. A 5- or even a 10-percent royalty on a small commercial volume, would, perhaps, have been fair and equitable, but the same percentage of royalty applied upon a hundred or a thousand times greater volume due to the war becomes excessive.”

Certainly then, the object of the act is to bring about a readjustment of royalties where wartime production has so accelerated the return to the licensor that the amounts which he receives are disproportionate to the returns reasonably to have been anticipated under peacetime conditions.

The issue has arisen as to the exact nature of the relationship between royalty adjustment and renegotiation. Does the Royalty Adjustment Act exclude patent royalties from the field of renegotiation and is the Renegotiation Act so drawn as to apply to amounts received by way of royalties? The objectives of renegotiation and royalty adjustment are immediately recognized as being very similar. They are both founded upon a policy of preventing the realization of unreason-
able profits which arise out of war conditions. If renegotiation is also applicable to patent royalties, then it would appear that these two statutes overlap to a certain degree. Renegotiation, however, applies retroactively and the Royalty Adjustment Act applies only prospectively—in futuro. It has been argued that Congress did not intend renegotiation to apply to the receipt of royalties since an overlapping of statutory authority dealing with the same matter would result. But the Royalty Adjustment Act was enacted after the Renegotiation Act and it appears rather definitely that the framers of the Royalty Adjustment Act did not intend to withdraw patent royalties from the area of renegotiation for that act provides:

"Nothing herein contained shall be deemed to preclude the applicability of Section 403 of Public Law 528, Seventy-seventh Congress, as the same may be heretofore or hereafter amended so far as the same may be applicable." 183

The definition of "subcontract" found in the Renegotiation Act as it was originally enacted probably did not cover the renegotiation of royalties. 185 And it is apparent from the hearings held when the Royalty Adjustment Act was pending before Congress that those who testified before the House Committee on Patents did not feel that the Renegotiation Law as it then stood, covered amounts received by way of royalties. 186

183 Id. at p. 39:

"It is a short section, and I will read it at this time:

'Nothing herein contained shall be deemed to preclude the applicability of section 403 of Public Law 528, Seventy-seventh Congress, as the same may be heretofore or thereafter amended so far as the same may be found applicable."

"Now, section 403 of Public Law 528 deals with renegotiation of contracts, and as the committee knows, there is now pending, I believe, a bill which has already been passed by the Senate which amends section 403 with regard to the renegotiation of contracts, and it is thought that because of the fact that it is not known whether this bill would be acted upon by the Congress prior to the enactment of that amendment that there should be no question as to this law being subject to and not acting as a repeal in any way of any of the provisions of the renegotiation statute."

184 Section 9, Royalty Adjustment Act of 1942.

185 Section 403 (a), Sixth Supplemental National Defense Appropriation Act, Pub. L. 528, 77th Cong., 2d sess., approved April 28, 1942, 56 Stat. L. 226 at 245:

"For the purposes of subsections (d) and (e) of this section, the term 'contract' includes a subcontract and the term 'contractor' includes a subcontractor."

186 Statement of Col. Earl S. Patterson in H. Hearings on H.R. 7620, 77th Cong., 2d sess., October 13, 14 and 15, 1942 at p. 21 (Committee on Patents):

"In our opinion, existing royalties can, in all fairness to the inventor or the patent holder, be reduced to effect a really huge saving in the War Department procurement. "This bill [The Royalty Adjustment Act] is, in the opinion of the War Depa-
At the time the hearings on the Royalty Adjustment Act were being conducted there was also pending in Congress an amendment to the Renegotiation Act. It is apparent from the testimony before the House Committee considering the Royalty Adjustment Act that it was the intention of the framers of that act to neither limit nor restrict the scope of renegotiation and that it was to stand wholly apart from renegotiation and to be conducted separately irrespective of the scope of renegotiation. It is believed, therefore, that the existence of the Royalty Adjustment Act does not in and of itself preclude the application of the Renegotiation Act to royalties. Whether the Renegotiation Act covers amounts received as royalties remains for inquiry.

On October 21, 1942 the Renegotiation Act was amended. Among the alterations made in the act was the change in the definition of "subcontract." There appears for the first time in that act this language, and although the Renegotiation Act has been amended several times, the best method of meeting the Army's present needs. It covers cases which cannot be reached by requisitioning or other remedies."

Letter from James Forrestal then Acting Secretary of the Navy, p. 32:

"The Navy Department has found that in many instances, manufacturers with whom contracts for the production of material for the Navy Department have been placed are operating under licensing agreements, entered into prior to our entry into the war, binding such manufacturers to pay specific royalties. These royalties under peacetime conditions and for the quantities then being produced may be considered fair and reasonable, but when applied to the enormous quantities needed for the prosecution of the war, these royalty rates are regarded in some cases as exorbitant, excessive and unfair.

"This situation, in a number of instances has been somewhat relieved by negotiations between representatives of the Navy Department and the owners of the patents. This method, however, has not been entirely successful because patent owners are legally entitled to require observance of existing contractual obligations.

"The proposed legislation will provide a much needed remedy for the conditions."

(Italics supplied).

Statement of Mr. Ralph L. Chappell, p. 41:

"Well, I believe that this legislation will touch primarily royalties which have not yet been paid. However, it is not at all unreasonable to think that in determining what is a reasonable royalty the test might be considered. I do not think there is any specific authorization in the bill and no intention of going back of a situation where the royalty has actually been paid."

Statement of Mr. Lanham, p. 42:

"In other words, under the renegotiation statute there would be no opportunity to recoup for the Government unreasonable fees that have been paid."

187 See Statement of Col. Earl S. Patterson, id. at p. 39. At page 40 he said:

"I intend to convey the thought to the committee that whatever contract was made in settlement of a controversy existing under this bill, if it in turn came within the provisions of the renegotiation statute, as amended, then, of course, it would be subject to renegotiation. It is not our intent to enlarge or limit the renegotiation law."

times and the definition of "subcontract" has been considerably expanded, this language is substantially retained:

"The term 'subcontract' means any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract or subcontract. The term 'article' includes any material, part, assembly, machinery, equipment, or other personal property."  

If renegotiation applies to patent royalties, it must be because of the definition of "subcontract." No other section of the Renegotiation Act can reasonably be construed to include them. Therefore, if royalties are renegotiable they must first be personal property, second be "required for the performance" of another contract and third, must be received in such an amount as to take the recipient outside of the statutory exemption which is measured by the volume of renegotiable business during the fiscal year. As to the first issue, little doubt can be entertained but that inventions or patents upon which royalties are being paid are personal property.

The term "subcontract" was further amended by Pub. L. 149, 78th Cong., 1st sess., approved July 14, 1943, 57 Stat. L. 564, to read as follows:

"The term 'subcontract' means (i) any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of any other contract or subcontract or (ii) any contract or arrangement (other than a contract or arrangement between two contracting parties, one of which parties is found by the Secretary to be a bona fide executive officer, partner, or full-time employee of the other contracting party), (A) any amount payable under which is contingent upon the procurement of a contract or contracts with a Department or of a subcontract or subcontracts thereunder, or determined with reference to the amount of such a contact or subcontract or such contracts or subcontracts, or (B) under which any part of the services performed or to be performed consists of the soliciting, attempting to procure, or procuring a contract or contracts with a Department or a subcontract or subcontracts thereunder: Provided, That nothing in this sentence shall be construed (1) to affect in any way the validity or construction of provisions in any contract with a Department or any subcontract thereunder, heretofore at any time or hereafter made, prohibiting the payment of contingent fees or commissions; or (2) to restrict in any way the authority of the Secretary to determine the nature or amount of selling expenses under subcontracts as defined in (ii) herein, as a proper element of the contract price or as a reimbursable item of cost, under a contract with a Department or a subcontract thereunder."

This definition of subcontract is applicable to fiscal years ending before July 1, 1943. The Revenue Act of 1943 altered the term "subcontract" by excluding from its operation contracts for the furnishing of office supplies and made certain other technical changes so as to conform this definition with the features of the 1943 Act relative to the creation of the War Contracts Price Adjustment Board. The essential features of the term "subcontract," however, have not been redefined and remain the same as are stated in the text of this article.

Consolidated Fruit-Jar Co. v. Wright, 94 U.S. 92 at 96 (1876); Marsh v.
Whether an invention is an "article," that is, personal property which is "required for the performance of any other contract or sub-
contract" is a topic of somewhat greater difficulty. The problem, how-
ever, seems to yield to the analysis that if a certain invention is used in
the performance of a contract, it is required to do the work under the
contract and, of course, an agreement with the owner of the patented
or unpatented invention for the payment of royalties is necessary to
permit its use. This would seem true even though the company using
or manufacturing the thing to which the invention applies had a choice
of several of such inventions, any one of which would permit the
work at its completion to be furnished directly or indirectly to one of
the renegotiating agencies. In the sense that one such invention is
necessary to perform the work, the invention which is used may be
said "to be required" for the performance of the other contract.

The legislative history of the Renegotiation Act gives a pretty clear
indication that Congress considered and intended renegotiation to
apply to royalties. When the first amendments to renegotiation were
being considered in September, 1942, which resulted in changing the
definition of "subcontract" as already mentioned, the War Department
asked that it be given the power to exempt patent license agreements
from renegotiation by administrative action.\(^{191}\)

It does not appear whether the War Department considered that
the law as it then stood gave the authority to renegotiate patent royalty-
ties or whether the contemplated amendments which redefine "subcon-
tract" would give such authority. Regardless of this consideration Con-
gress clearly believed that the 1942 Renegotiation Act permits the
renegotiation of royalties and intended that the 1943 Act also obtain
with regard to them.

Nichols, 128 U.S. 605 at 612 (1888); Continental Paper Bag Co. v. Eastern Paper
Bag Co., 210 U.S. 405 at 424, 28 S. Ct. 748 (1908); United States v. Dublier Con-

Wholly apart from the grant of a patent, the inventor has rights relative to the
manufacture, use and sale of his invention and has the further right to deprive the
public of its benefits by maintaining it in secrecy. Chemical Foundation, Inc. v.
U.S. 654, 59 S. Ct. 249 (1938). An unpatented invention, therefore, seems also to
possess the qualities of personal property.

\(^{191}\) Statement of Mr. William L. Marbury in S. Hearings on § 403 of Pub. L.
No. 528, 77th Cong., 2d sess., September 22, 1942, (Committee on Finance) at p. 39:
"... In the opinion of the War Department, the Secretary should have authority
to exempt contracts of these types from renegotiation whenever he thinks it justified.
"Certain types of patent license agreements, certain types of leases, contracts to
be performed in Mexico, in Africa. ..."
The Revenue Bill of 1943, H.R. 3687 as it was introduced in the House by Representative Doughton on November 18, 1943 defined the term “excessive profits” in this way (p. 155):

“The term ‘excessive profits’ means the portion of the profits derived from contracts with the Departments and subcontracts which is determined in accordance with this section to be excessive for the work and articles furnished. (Italics supplied).

The term “subcontract” was defined in this way (p. 158):

“The term ‘subcontract’ means (A) any purchase order or agreement (other than a contract with a Department) to make or furnish, or to perform any part of the work required for the making or furnishing of, a contract item or a component article. For the purposes of this subparagraph (i) a ‘contract item’ means any article, work, service, building, structure, improvement or facility contracted for by a Department; (ii) a ‘component article’ means any article which is to be incorporated in or as a part of a contract item.”

The phrase “for the work and articles furnished” found in the definition of excessive profits in this bill when coupled with the suggested definition of subcontract, cast some doubt upon whether the proposed bill would obtain with respect to the renegotiation of royalties. Therefore, the senate and house conferees agreed to eliminate these phrases and left the definition of subcontract with the same meaning, as far as patent royalties are concerned, that it had prior to the passage of the Revenue Act of 1943.192

If license agreements calling for the payment of royalties are renegotiable when made under other renegotiable contracts, what amount aside from other income must the licensor receive during a fiscal year to

192 H. Rep. No. 1079 on H.R. 3687, 78th Cong., 1st sess., 1943 (Conference Committee) at p. 76:

“Amendment No. 218: This amendment eliminates a phrase [for the work and articles furnished] which would cast doubt on the includibility in the term ‘excessive profits,’ as used in the Renegotiation Act, of any portion of the profits derived from patent license agreements. The House recedes.”

Statement of Mr. Joseph M. Dodge in S. Hearings on H.R. 3687, 78th Cong., 1st sess., December 6, 1943 (Committee on Finance) at p. 1080:

“Under the present law, it is clear that patent royalty contracts and other agreements involving intangible property rights are subject to renegotiation. The House bill, in defining ‘subcontract’ and ‘excessive profits’ raises a substantial question as to whether contracts of this type are renegotiable. This question should be resolved by clarifying the definition of a contract ‘article’ by adding the words ‘tangible or intangible’ immediately following the phrase ‘other personal property.’”
be subject to renegotiation? With regard to the 1942 Act, royalties appear to be renegotiable by the terms of subsection (a) (5) (i), and by the terms of the 1943 Act by subsection (a) (5) (A). In the case of the renegotiation of a fiscal year ending before July 1, 1943, the act is not applicable to any contractor whose aggregate sales arising from contracts and subcontracts do not exceed $100,000 or, where brokers and agents are concerned as described in subsection (a) (5) (ii) of that act, where the subcontractor has not received $25,000 for the fiscal year involved. It is very evident that if license agreements are subcontracts under renegotiation, they fall into this category by virtue of the definition which defines subcontract as “any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of any other contract or subcontract.” License agreements do not become renegotiable by virtue of that part of the Renegotiation Act which relates to amounts received by brokers and agents, making them subject to the act when they have received $25,000 or more of renegotiable income. Thus licensors are not subject to renegotiation unless they have received $100,000 during fiscal years ending before July 1, 1943 or $500,000 for fiscal years ending after June 30, 1943. If less than these amounts are received, except in those cases where a licensor may have received other income which brings him within the purview of the act, royalties received by the licensor are not renegotiable.

(To be Concluded in the October Issue of The Review.)

193 Subsection (c)(6)(iii) of the 1942 Act. Subsection (a)(5)(ii) of this act relates to amounts received by brokers and agents not employees of the contractor. In the 1943 Act subsection (c)(6) raises the amount with respect to contracts and subcontracts from $100,000 to $500,000 but the amount with respect to sums received by brokers and agents remains at $25,000.

194 Computed with regard to both the 1942 and 1943 Acts by including amounts received under contracts and subcontracts (exempted by other provisions of the act) as provided in subsections (c)(6) of both the 1942 and 1943 Acts.