31.205-6 Compensation for personal services.

(a) *General. Compensation for personal services* is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) *Compensation for personal services must* be for work performed by the employee in the current year and *must* not represent a retroactive adjustment of prior years' salaries or wages (but see paragraphs (g), (h), (j), (k), (m), and (o) of this subsection).

(2) The total compensation for individual employees or *job* classes of employees *must* be reasonable for the work performed; however, specific restrictions on individual compensation elements apply when prescribed.

(3) The compensation *must* be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor has not provided the cognizant ACO, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) *Costs* that are unallowable under other paragraphs of this subpart 31.2 are not allowable under this subsection 31.205-6 solely on the basis that they constitute *compensation for personal services*.

(6)

(i) Compensation *costs* for certain individuals give rise to the need for special consideration. Such individuals include:

(A) Owners of closely held corporations, members of limited liability *companies*, partners, sole proprietors, or members of their immediate families; and

(B) Persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise.

(ii) For these individuals, compensation *must*-

(A) Be reasonable for the personal services rendered; and

(B) Not be a distribution of profits (which is not an allowable contract cost).

(iii) For owners of closely held *companies*, compensation in excess of the *costs* that are deductible as compensation under the Internal Revenue Code (26 U.S.C.) and regulations under it is unallowable.

(b) Reasonableness-

(1) *Compensation pursuant to labor-management agreements*. If *costs* of compensation established under "arm's length" labor-management agreements negotiated under the terms of the Federal Labor Relations Act or similar state statutes are otherwise allowable, the *costs* are reasonable

unless, as applied to work in performing Government contracts, the *costs* are unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (*e.g.,* work involving extremely hazardous activities or work not requiring recurrent use of *overtime*) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (*e.g.,* work involving less hazardous activities or work continually requiring use of *overtime*). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances.

(2) *Compensation not covered by labor-management agreements*. Compensation for each employee or *job class of employees must* be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation, consider only allowable individual elements of compensation. In addition to the provisions of 31.201-3, in testing the reasonableness of compensation for particular employees or *job* classes of employees, consider factors determined to be relevant by the *contracting officer*. Factors that *may* be relevant include, but are not limited to, conformity with compensation practices of other firms-

(i) Of the same size;

(ii) In the same industry;

(iii) In the same geographic area; and

(iv) Engaged in similar non-Government work under comparable circumstances.

(c) [Reserved]

(d) Form of payment.

(1) *Compensation for personal services* includes compensation paid or to be paid in the future to employees in the form of-

(i) Cash;

(ii) Corporate securities, such as stocks, bonds, and other financial instruments (see paragraph (d)(2) of this subsection regarding valuation); or

(iii) Other assets, *products*, or services.

(2) When compensation is paid with securities of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the securities is the fair market value on the first date the number of shares awarded is known, determined upon the most objective basis available.

(ii) Accruals for the cost of securities before issuing the securities to the employees are subject to adjustment according to the possibilities that the employees will not receive the securities and that their interest in the accruals will be forfeited.

(e) Income tax differential pay.

(1) Differential allowances for additional income taxes resulting from foreign assignments are allowable.

(2) Differential allowances for additional income taxes resulting from domestic assignments are unallowable. (However, payments for increased employee income or Federal *Insurance* Contributions Act taxes incident to allowable reimbursed relocation *costs* are allowable under 31.205-35(a)(10).)

(f) Bonuses and incentive compensation.

(1) Bonuses and incentive compensation are allowable provided the-

(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and

(ii) Basis for the award is supported.

(2) When the bonus and incentive compensation payments are deferred, the *costs* are subject to the requirements of paragraphs (f)(1) and (k) of this subsection.

(g) *Severance pay*.

(1) Severance pay is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in paragraph (j)(6) of this subsection.

(2) Severance pay is allowable only to the extent that, in each case, it is required by-

(i) Law;

(ii) Employer-employee agreement;

(iii) Established policy that constitutes, in effect, an implied agreement on the contractor’s part; or

(iv) Circumstances of the particular employment.

(3) Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent *company* of the contractor are not severance pay and are unallowable.

(4) Actual normal turnover severance payments *shall* be allocated to all work performed in the contractor’s plant. However, if the contractor uses the accrual method to account for normal turnover severance payments, that method will be acceptable if the amount of the accrual is-

(i) Reasonable in light of payments actually made for normal severances over a representative past period; and

(ii) Allocated to all work performed in the contractor’s plant.

(5) Abnormal or mass severance pay is of such a conjectural nature that accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, the Government will consider allowability on a case-by-case basis.

(6) Under 10 U.S.C. 3744(a)(13) and 41 U.S.C. 4304(a)(13), the *costs* of severance payments to foreign nationals employed under a service contract performed outside the *United States* are unallowable to the extent that such payments exceed amounts typically paid to employees providing similar services in the same industry in the *United States*. Further, under 10 U.S.C. 3744(a)(14) and 41 U.S.C. 4304(a)(14), all such *costs* of severance payments that are otherwise allowable are unallowable if the termination of employment of the foreign national is the result of the closing of, or the curtailment of activities at, a *United States* facility in that country at the request of the government of that country; this does not apply if the closing of a facility or curtailment of activities is made pursuant to a status-of-forces or other country-to-country agreement entered into with the government of that country before November 29, 1989. 10 U.S.C. 3744(b) and 41 U.S.C. 4304(b) permit the *head of the agency* to waive these cost allowability limitations under certain circumstances (see 37.113 and the *solicitation* provision at 52.237-8).

(h) *Backpay*. Backpay is a retroactive adjustment of prior years' salaries or wages. Backpay is unallowable except as follows:

(1) Payments to employees resulting from underpaid work actually performed are allowable, if required by a negotiated settlement, order, or court decree.

(2) Payments to union employees for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiation are allowable.

(3) Payments to nonunion employees based upon results of union agreement negotiation are allowable only if-

(i) A formal agreement or understanding exists between management and the employees concerning these payments; or

(ii) An established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payments.

(i) Compensation based on changes in the prices of corporate securities or corporate security ownership, such as stock *options*, stock appreciation rights, phantom stock plans, and junior stock conversions.

(1) Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable.

(2) Any compensation represented by dividend payments or which is calculated based on dividend payments is unallowable.

(3) If a contractor pays an employee in lieu of the employee receiving or exercising a right, *option*, or benefit which would have been unallowable under this paragraph (i), such payments are also unallowable.

(j) Pension *costs*.

(1) *Pension plans* are normally segregated into two types of plans: defined-benefit and *defined-contribution pension plans*. The contractor *shall* measure, assign, and *allocate* the *costs* of all *defined-benefit pension plans* and the *costs* of all *defined-contribution pension plans* in compliance with 48 CFR9904.412-Cost Accounting Standard for Composition and Measurement of Pension Cost, and 48 CFR9904.413-Adjustment and Allocation of Pension Cost. Pension *costs* are allowable subject to the referenced standards and the cost limitations and exclusions set forth in paragraph (j)(1)(i) and in paragraphs (j)(2) through (j)(6) of this subsection.

(i) Except for *nonqualified pension plans* using the *pay-as-you-go cost method*, to be allowable in the current year, the contractor *shall* fund pension *costs* by the time set for filing of the Federal income tax return or any extension. Pension *costs* assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year. For *nonqualified pension plans* using the pay-as-you-go method, to be allowable in the current year, the contractor *shall allocate* pension *costs* in the cost accounting period that the pension *costs* are assigned.

(ii) Pension payments *must* be paid pursuant to an agreement entered into in good faith between the contractor and employees before the work or services are performed and to the terms and conditions of the established plan. The cost of changes in *pension plans* are not allowable if the changes are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future.

(iii) Except as provided for early retirement benefits in paragraph (j)(6) of this subsection, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension *costs*, unless the supplemental benefits represent a separate *pension plan* and the benefits are payable for life at the *option* of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of-living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(2) *Defined-benefit pension plans*. The cost limitations and exclusions pertaining to defined-benefit plans are as follows:

(i)

(A) Except for *nonqualified pension plans*, pension *costs* (see 48 CFR9904.412-40(a)(1)) assigned to the current accounting period, but not funded during it, are not allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any portion of pension cost computed for a cost accounting period, that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of the Employee Retirement Income Security Act of1974 (ERISA), will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR9904.412-50(c)(5)).

(B) For *nonqualified pension plans*, except those using the *pay-as-you-go cost method*, allowable *costs* are limited to the amount allocable in accordance with 48 CFR9904.412-50(d)(2).

(C) For *nonqualified pension plans* using the *pay-as-you-go cost method*, allowable *costs* are limited to the amounts allocable in accordance with 48 CFR9904.412-50(d)(3).

(ii) Any amount funded in excess of the pension cost assigned to a cost accounting period is not allowable in that period and *shall* be accounted for as set forth at 48 CFR9904.412-50(a)(4). The excess amount is allowable in the future period to which it is assigned, to the extent it is not

otherwise unallowable.

(iii) Increased pension *costs* are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable. If a composite rate is used for allocating pension *costs* between the *segments* of a *company* and if, because of differences in the timing of the funding by the *segments*, an inequity exists, allowable pension *costs* for each *segment* will be limited to that particular *segment*'s calculation of pension *costs* as provided for in 48 CFR9904.413-50(c). The contractor *shall* make determinations of *unallowable costs* in accordance with the actuarial method used in calculating pension *costs*.

(iv) The *contracting officer* will consider the allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGC) under ERISA Section 4062 or 4064 arising from terminating an employee *deferred compensation* plan on a case-by-case basis, provided that if *insurance* was required by the PBGC under ERISA Section 4023, it was so obtained and the indemnification payment is not recoverable under the *insurance*. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205-19(c)(3) and (d)(3), in the indemnification payment to the extent of its fair share.

(v) Increased pension *costs* resulting from the withdrawal of assets from a pension fund and transfer to another employee benefit plan fund, or transfer of assets to another account within the same fund, are unallowable except to the extent authorized by an advance agreement. If the withdrawal of assets from a pension fund is a plan termination under ERISA, the provisions of paragraph (j)(3) of this subsection apply. The advance agreement *shall*-

(A) State the amount of the Government's equitable share in the gross amount withdrawn or transferred; and

(B) Provide that the Government receives a credit equal to the amount of the Government's equitable share of the gross withdrawal or transfer.

(3) Pension adjustments and asset reversions.

(i) For *segment* closings, *pension plan* terminations, or curtailment of benefits, the amount of the adjustment *shall* be-

(A) For contracts and subcontracts that are subject to full coverage under the Cost Accounting Standards (CAS) Board rules and regulations, the amount measured, assigned, and allocated in accordance with 48 CFR9904.413-50(c)(12); and

(B) For contracts and subcontracts that are not subject to full coverage under the CAS, the amount measured, assigned, and allocated in accordance with 48 CFR9904.413-50(c)(12), except the numerator of the fraction at 48 CFR9904.413-50(c)(12)(vi) is the sum of the *pension plan costs* allocated to all non-CAS-covered contracts and subcontracts that are subject to subpart 31.2 or for which *certified cost or pricing data* were submitted.

(ii) For all other situations where assets revert to the contractor, or such assets are constructively received by it for any reason, the contractor *shall*, at the Government's *option*, make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn. The Government's equitable share *shall* reflect the Government's participation in pension *costs* through those contracts for which *certified cost or pricing data* were submitted or that are subject to subpart 31.2. Excise

taxes on *pension plan* asset reversions or withdrawals under this paragraph (j)(3)(ii) are unallowable in accordance with 31.205-41(b)(6).

(4) *Defined-contribution pension plans.* In addition to *defined-contribution pension plans*, this paragraph also covers profit sharing, savings plans, and other such plans, provided the plans fall within the definition of a *pension plan* at 31.001.

(i) Allowable pension cost is limited to the net contribution required to be made for a cost accounting period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR9904.412-50(c)(5)).

(ii) The provisions of paragraphs (j)(2)(ii) and (iv) of this subsection apply to defined-contribution plans.

(5) *Pension plans using the pay-as-you-go cost method*. When using the *pay-as-you-go cost method*, the contractor *shall* measure, assign, and *allocate* the cost of *pension plans* in accordance with 48 CFR9904.412 and 9904.413. Pension *costs* for a *pension plan* using the *pay-as-you-go cost method* are allowable to the extent they are not otherwise unallowable.

(6) *Early retirement incentives*. An early retirement incentive is an incentive given to an employee to retire early. For contract costing purposes, *costs* of early retirement incentives are allowable subject to the pension cost criteria contained in paragraphs (j)(2)(i) through (iv) of this subsection provided-

(i) The contractor measures, assigns, and *allocates* the *costs* in accordance with the contractor's accounting practices for pension *costs;*

(ii) The incentives are in accordance with the terms and conditions of an early retirement incentive plan;

(iii) The contractor applies the plan only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The present value of the total incentives given to any employee in excess of the amount of the employee's annual salary for the previous *fiscal year* before the employee's retirement is unallowable. The contractor *shall* compute the present value in accordance with its accounting practices for pension *costs*. The contractor *shall* account for any *unallowable costs* in accordance with 48 CFR9904.412-50(a)(2).

(k) *Deferred compensation other than pensions.* The *costs* of *deferred compensation* awards are allowable subject to the following limitations:

(1) The *costs shall* be measured, assigned, and allocated in accordance with 48 CFR 9904.415, Accounting for the Cost of *Deferred Compensation*.

(2) The *costs* of *deferred compensation* awards are unallowable if the awards are made in periods subsequent to the period when the work being remunerated was performed.

(l) Compensation incidental to business *acquisitions*. The following *costs* are unallowable:

(1) Payments to employees under agreements in which they receive special compensation, in excess of the contractor's normal severance pay practice, if their employment terminates following a change in the management control over, or ownership of, the contractor or a substantial portion of its assets.

(2) Payments to employees under plans introduced in connection with a change (whether actual or prospective) in the management control over, or ownership of, the contractor or a substantial portion of its assets in which those employees receive special compensation, which is contingent upon the employee remaining with the contractor for a specified period of time.

(m) *Fringe benefits*.

(1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee *insurance*, and supplemental unemployment benefit plans. Except as provided otherwise in subpart 31.2, the *costs* of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor.

(2) That portion of the cost of *company*-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see 31.205-46(d)).

(n) *Employee rebate and purchase discount plans.* Rebates and purchase discounts, in whatever form, granted to employees on *products* or services produced by the contractor or *affiliates* are unallowable.

(o) Postretirement benefits other than pensions (PRB).

(1) PRB covers all benefits, other than cash benefits and life *insurance* benefits paid by *pension plans*, provided to employees, their beneficiaries, and covered dependents during the period following the employees' retirement. Benefits encompassed include, but are not limited to, postretirement health care; life *insurance* provided outside a *pension plan*; and other welfare benefits such as tuition assistance, *day* care, legal services, and housing subsidies provided after retirement.

(2) To be allowable, PRB *costs shall* be incurred pursuant to law, employer-employee agreement, or an established policy of the contractor, and *shall* comply with paragraphs (o)(2)(i), (ii), or (iii) of this subsection.

(i) Pay-as-you-go. PRB *costs* are not accrued during the working lives of employees. *Costs* are assigned to the period in which-

(A) Benefits are actually provided; or

(B) The *costs* are paid to an insurer, provider, or other recipient for current year benefits or premiums.

(ii) *Terminal funding.* PRB *costs* are not accrued during the working lives of the employees.

(A) Terminal funding occurs when the entire PRB liability is paid in a lump sum upon the termination

of employees (or upon conversion to such a terminal-funded plan) to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees.

(B) Terminal funded *costs shall* be amortized over a period of 15 years.

(iii) *Accrual basis*. PRB *costs* are accrued during the working lives of employees. Accrued PRB *costs shall* comply with the following:

(A) Be measured and assigned in accordance with one of the following two methods described under paragraphs (o)(2)(iii)(A)(1) or (o)(2)(iii)(A)(2) of this subsection:

(1) Generally accepted accounting principles. However, transitions from the pay-as-you-go method to the accrual accounting method *must* be handled according to paragraphs (o)(2)(iii)(A)(1)(i) through (iii) of this subsection.

(i) In the year of transition from the pay-as-you-go method to accrual accounting for purposes of Government contract cost accounting, the transition obligation *shall* be the excess of the accumulated PRB obligation over the fair value of plan assets determined in accordance with subparagraph (E) of this section; the fair value *must* be reduced by the prepayment credit as determined in accordance with subparagraph (o)(2)(iii)(F) of this subsection.

(ii) PRB cost attributable to the transition obligation assigned to the current year that is in excess of the amount assignable to accounting periods on the basis of a straight line amortization of the transition obligation over the average remaining working lives of active employees covered by the PRB plan or a 20-year period, whichever period is longer, is unallowable. However, if the plan is comprised of inactive participants only, the PRB cost attributable to the transition obligation assigned to the current year that is in excess of the amount assignable to accounting periods on a straight line amortization of the transition obligation over the average future life expectancy of the participants is unallowable.

(iii) For a plan that transitioned from pay-as-you-go to accrual accounting for Government contract cost accounting prior to July 22, 2013, the unallowable amount of PRB cost attributable to the transition obligation amortization *shall* continue to be based on the cost principle in effect at the time of the transition until the original transition obligation schedule is fully amortized.

(2) Contributions to a *welfare benefit fund* determined in accordance with applicable Internal Revenue Code. Allowable PRB *costs* based on such contributions *shall*-

(i) Be measured using reasonable actuarial assumptions, which *shall* include a health care inflation assumption unless prohibited by the Internal Revenue Code provisions governing *welfare benefit funds*;

(ii) Be assigned to accounting periods on the basis of the average working lives of active employees covered by the PRB plan or a 15 year period, whichever period is longer. However, if the plan is comprised of inactive participants only, the cost *shall* be spread over the average future life expectancy of the participants; and

(iii) Exclude Federal income taxes, whether incurred by the fund or the contractor (including any increase in PRB *costs* associated with such taxes), unless the fund holding the plan assets is tax-exempt under the provisions of 26 USC 501(c).

(B) Be paid to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The assets *shall* be segregated in the trust, or otherwise effectively

restricted, so that they cannot be used by the employer for other purposes.

(C) Be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

(D) Eliminate from *costs* of current and future periods the accumulated value of any prior period *costs* that were unallowable in accordance with paragraph (o)(3) of this section, adjusted for interest under paragraph (o)(4) of this section.

(E) Calculate the unfunded actuarial liability (unfunded accumulated postretirement benefit obligation) using the market (fair) value of assets that have been accumulated by funding *costs* assigned to prior periods for contract accounting purposes.

(F) Recognize as a prepayment credit the market (fair) value of assets that were accumulated by deposits or contributions that were not used to fund *costs* assigned to previous periods for contract accounting purposes.

(G) Comply with the following when changing from one accrual accounting method to another: the contractor *shall*-

(1) Treat the change in the unfunded actuarial liability (unfunded accumulated postretirement benefit obligation) as a gain or loss; and

(2) Present an analysis demonstrating that all *costs* assigned to prior periods have been accounted for in accordance with paragraphs (o)(2)(iii)(D), (E), and (F) of this section to ensure that no duplicate recovery of *costs* exists. Any duplicate recovery of *costs* due to the change from one method to another is unallowable. The analysis and new accrual accounting method *may* be a subject appropriate for an advance agreement in accordance with 31.109.

(3) To be allowable, PRB *costs must* be funded by the time set for filing the Federal income tax return or any extension thereof, or paid to an insurer, provider, or other recipient by the time set for filing the Federal income tax return or extension thereof. PRB *costs* assigned to the current year, but not funded, paid or otherwise liquidated by the tax return due date as extended are not allowable in any subsequent year.

(4) Increased PRB *costs* caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

(5) The Government *shall* receive an equitable share of any amount of previously funded PRB *costs* which revert or inure to the contractor. Such equitable share *shall* reflect the Government's previous participation in PRB *costs* through those contracts for which *certified cost or pricing data* were required or which were subject to subpart 31.2.

(p) *Limitation on allowability of compensation*.

Employee Compensation Limits

Contract Award Date	**Applicable Agencies**	**Covered Employees**	**31.205-6**

Contract Award Date	Applicable Agencies	Covered Employees	31.205-6
Before June 24, 2014	*Executive Agencies* Other than DoD, NASA and Coast Guard	Senior Executive	(p)(2)
Before December 31, 2011	DoD, NASA and Coast Guard	Senior Executive	(p)(2)
On/after December 31, 2011, and before June 24, 2014	DoD, NASA, and Coast Guard	All Employees	(p)(3)
On/after June 24, 2014	All *Executive Agencies*	All Employees	(p)(4)

(1) *Definitions*. As used in this paragraph (p)-

(i) "Compensation" means the total amount of wages, salary, bonuses, *deferred compensation* (see paragraph (k) of this subsection), and employer contributions to defined contribution *pension plans* (see paragraphs (j)(4) and (q) of this subsection), for the *fiscal year*, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the *fiscal year*.

(ii) "Senior executive" means–

(A) Prior to January 2, 1999–

(1) The Chief Executive Officer (CEO) or any individual acting in a similar capacity at the contractor's headquarters;

(2) The four most highly compensated employees in management positions at the contractor's headquarters, other than the CEO; and

(3) If the contractor has intermediate *home offices* or *segments* that report directly to the contractor's headquarters, the five most highly compensated employees in management positions at each such intermediate *home office* or *segment*.

(B) Effective January 2, 1999, the five most highly compensated employees in management positions at each *home office* and each *segment* of the contractor, whether or not the *home office* or *segment* reports directly to the contractor's headquarters.

(iii) *Fiscal year* means the *fiscal year* established by the contractor for accounting purposes.

(iv) Contractor's headquarters means the highest organizational level from which executive compensation *costs* are allocated to Government contracts.

(2) *Senior executive compensation limit for contracts awarded before June 24, 2014*.

(i) *Applicability*. This paragraph (p)(2) applies to the following:

(A) To all *executive agencies*, other than DoD, NASA and the Coast Guard, for contracts awarded before June 24, 2014;

(B) To DoD, NASA, and the Coast Guard for contracts awarded before December 31, 2011;

(ii) *Costs* incurred after January 1, 1998, for the compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor *fiscal year* by the Administrator, Office of Federal *Procurement* Policy (OFPP), under 41 U.S.C. 1127 as in effect prior to June 24, 2014, are unallowable (10 U.S.C. 3744(a)(16) and 41 U.S.C. 4304(a)(16), as in effect prior to June 24, 2014). This limitation is the sole statutory limitation on allowable senior executive compensation *costs* incurred after January 1, 1998, under contracts awarded before June 24, 2014, and applies whether or not the affected contracts were previously subject to a statutory limitation on such *costs*. (Note that pursuant to section 804 of Pub. L. 105-261, the definition of "senior executive" in paragraph (p)(1) of this section has been changed for compensation *costs* incurred after January 1, 1999.) See https://www.whitehouse.gov/wp-content/uploads/2017/11/ContractorCompensationCapContractsAwardedBeforeJune24.pdf.

(3) All employee compensation limit for contracts awarded before June 24, 2014.

(i) *Applicability.* This paragraph (p)(3) applies to DOD, NASA, and the Coast Guard for contracts awarded on or after December 31, 2011, and before June 24, 2014.

(ii) *Costs* incurred after January 1, 2012, for the compensation of any contractor employee in excess of the benchmark compensation amount, determined applicable for the contractor *fiscal year* by the Administrator, Office of Federal *Procurement* Policy (OFPP) under 41 U.S.C. 1127 as in effect prior to June 24, 2014 are unallowable (10 U.S.C. 3744(a)(16) as in effect prior to June 24, 2014.) This limitation is the sole statutory limitation on allowable employee compensation *costs* incurred after January 1, 2012, under contracts awarded on or after December 31, 2011 and before June 24, 2014. (Note that pursuant to section 803 of Pub. L. 112-81, 10 U.S.C. 3744, Allowable *costs* under defense contracts, was amended by striking "senior executives" and inserting "any contractor employee", making unallowable the excess compensation *costs* incurred after January 1, 2012, under affected contracts.) See https://www.whitehouse.gov/wp-content/uploads/2017/11/ContractorCompensationCapContractsAwardedBeforeJune24.pdf.

(4) All employee compensation limit for contracts awarded on or after June 24, 2014.

(i) *Applicability.* This paragraph (p)(4) applies to all *executive agency* contracts awarded on or after June 24, 2014, and any subcontracts thereunder.

(ii) *Costs* incurred on or after June 24, 2014, for the compensation of all employees in excess of the benchmark compensation amount determined applicable for the contractor *fiscal year* by the Administrator, Office of Federal *Procurement* Policy (OFPP) are unallowable under 10 U.S.C. 3744(a)(16) and 41 U.S.C 4304(a)(16), as in effect on or after June 24, 2014, pursuant to section 702 of Pub. L. 113-67. This limitation is the sole statutory limitation on allowable employee compensation *costs* incurred on or after June 24, 2014, under contracts awarded on or after June 24, 2014. See http://www.whitehouse.gov/omb/procurement/cecp.

(iii) Exceptions. An *agency head may* establish one or more narrowly targeted exceptions for scientists, engineers, or other specialists upon a determination that such exceptions are needed to ensure that the *executive agency* has continued access to needed skills and capabilities. In making

such a determination, the agency *shall* consider, at a minimum, for each contractor employee in a narrowly targeted excepted position-

(A) The amount of taxpayer funded compensation to be received by each employee; and

(B) The duties and services performed by each employee.

(q) Employee stock ownership plans (ESOP).

(1) An ESOP is a stock bonus plan designed to invest primarily in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESOT) *may* be in the form of cash, stock, or property.

(2) *Costs* of ESOPs are allowable subject to the following conditions:

(i) The contractor measures, assigns, and *allocates costs* in accordance with 48 CFR 9904.415.

(ii) Contributions by the contractor in any oneyear that exceed the deductibility limits of the Internal Revenue Code for that year are unallowable.

(iii) When the contribution is in the form of stock, the value of the stock contribution is limited to the fair market value of the stock on the date that title is effectively transferred to the trust.

(iv) When the contribution is in the form of cash-

(A) Stock purchases by the ESOT in excess of fair market value are unallowable; and

(B) When stock purchases are in excess of fair market value, the contractor *shall* credit the amount of the excess to the same *indirect cost pools* that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the contractor *shall* credit the excess price over fair market value to the *indirect cost pools* pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan.

(v) When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

Parent topic: 31.205 Selected costs.