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United States General Accounting Office  
Washington, DC 20548

Resources, Community, and  
Economic Development Division

November 19, 1999

The Honorable F. James Sensenbrenner, Jr.  
Chairman  
Committee on Science  
The Honorable Bart Gordon  
Ranking Minority Member  
Subcommittee on Space and Aeronautics  
Committee on Science  
House of Representatives

Subject: Laboratory Research: Sales and Use Tax Costs to Build DOE's Spallation Neutron Source Project

The Spallation Neutron Source (SNS) project is the largest interlaboratory collaboration ever attempted by the Department of Energy (DOE). When completed, the SNS will be the world's most powerful accelerator-based facility for conducting experiments that are expected to lead to the production of new materials for use in applications ranging from aircraft and automobiles to drugs and computer hard drives.<sup>1</sup> Each of five DOE collaborating national laboratories is responsible for designing, building, and assembling separate components of the project. Estimated by DOE to cost about \$1.4 billion, the project is planned to be built in Oak Ridge, Tennessee, under the direct supervision of the Oak Ridge National Laboratory, which is currently managed by Lockheed Martin Energy Research Corporation (Lockheed Martin). Lockheed Martin will be replaced as the managing contractor by the partnership of the University of Tennessee and Battelle Memorial Institute (UT-Battelle) in April 2000. The four other national laboratories collaborating on the project are the Lawrence Berkeley National Laboratory in California, the Los Alamos National Laboratory in New Mexico, the Brookhaven National Laboratory in New York, and the Argonne National Laboratory in Illinois.

Concerned that the federal government might be required to reimburse the project's contractors about \$35 million in Tennessee sales and use taxes during the construction of the SNS, you asked us to determine if these tax expenses would be less if the project were built at any of the other four collaborating laboratories.<sup>2</sup> DOE generally reimburses its contractors for certain costs, including state sales and use taxes they incur in performing work for the Department. While these tax costs make up only a small portion of this project's total cost, at your request, we did not examine other costs that would be incurred if the SNS were to be built at another location. For example, differences in the cost of labor and materials could vary substantially among

<sup>1</sup>Accelerators increase the speed of subatomic particles to high energies toward targets. The resulting collisions produce effects useful for researching new materials.

<sup>2</sup>The House of Representatives also directed that no fiscal year 2000 funds be obligated for the construction of SNS until GAO reports that it would cost no more, from a tax standpoint, to construct the SNS in Tennessee than at any of the four other collaborating laboratories.

locations. As agreed with your offices, we used DOE's estimate of the tax costs of building the project in Tennessee and compared it to the tax costs at the collaborating laboratories in the four other states.<sup>3</sup> The taxes identified in DOE's estimate are state and local sales and use taxes charged on items sold or used in Tennessee.<sup>4</sup> Our objective was to identify a laboratory location with the lowest possible sales and use tax expenses that would relate to the SNS project. Our preliminary work indicated that the Brookhaven National Laboratory in New York would incur virtually no sales and use taxes if it were to construct the SNS. As a result, we did not compare tax costs at the three other laboratory locations, even though one or more of them could also be a low-cost site.

In summary, the cost of sales and use taxes to build the project at the Oak Ridge National Laboratory, using Lockheed Martin or UT-Battelle, would be more than if the project were built at the Brookhaven National Laboratory, where the current managing contractor and subcontractors incur virtually no sales and use taxes. This is because New York has exemptions that Brookhaven's contractor, a tax-exempt, not-for-profit organization, and its for-profit subcontractors can use. In contrast, Tennessee does not have similar tax exemptions that the current or incoming Oak Ridge contractor qualifies for. Thus, Lockheed Martin, a for-profit organization, and UT-Battelle, a not-for-profit, limited liability corporation that is not recognized by Tennessee as tax-exempt, would pay sales and use taxes.

### Background

Tennessee charges sales taxes on certain items sold and use taxes on similar items that are brought into or used in that state if the items have not been previously taxed. Tennessee's local governments charge sales and use taxes on the same items that the state taxes. These and other taxes become part of the construction costs of federal projects because, when incurred, they are paid by the contractor and subsequently reimbursed by the government.

States and local governments prescribe the taxability of entities and transactions within their jurisdictions. One major difference in the amount of taxes paid is the tax status of each entity. Except for Oak Ridge, the managing contractors of the collaborating laboratories are not-for-profit organizations that have been provided favorable tax treatment on certain aspects of their operations. In New York, for-profit subcontractors that work for not-for-profit contractors also may be exempt from sales and use taxes.

### The Sales and Use Taxes to Construct the SNS Would Be More at the Oak Ridge National Laboratory

The sales and use taxes to build the SNS at the Oak Ridge National Laboratory would be greater than if the project were constructed at the Brookhaven National Laboratory. According to our review, New York's tax code has several provisions that would result in virtually no payment of sales and use taxes for the SNS project if it were built there. However, the estimated difference in the SNS project's total sales and use tax costs if the project were constructed in New York would depend on what components of the project would be completed at Oak Ridge. According to an SNS project official, the Oak Ridge contractor would pay an estimated \$2.6 million in Tennessee sales and use taxes for building its component of the SNS, even if the project were constructed at another laboratory.

<sup>3</sup>DOE's original cost estimate for sales and use taxes was revised from \$35.4 million to \$28.3 million in July 1999. We did not independently verify these tax estimates or the underlying assumptions used to generate them.

<sup>4</sup>We refer to these types of taxes as sales and use taxes in this report.

The managing contractor for the Brookhaven National Laboratory is Brookhaven Science Associates (BSA), a not-for-profit tax-exempt organization under New York state law. Although BSA uses for-profit subcontractors to perform work at the laboratory, according to New York State Department of Taxation and Finance personnel and BSA and DOE officials at that laboratory, several state tax provisions would work in tandem to effectively exempt the SNS project from New York sales and use taxes if it were built by BSA at the Brookhaven National Laboratory. These officials also told us that sales and use taxes in Suffolk County, where the Brookhaven Laboratory is located, are essentially additions to the state sales and use taxes and when SNS transactions are exempt from the state sales and use taxes, they would also be exempt from those county taxes. Also, New York law allows certain tax exemptions for some activities of its for-profit contractors that are not available to similar organizations in Tennessee.

In contrast, Lockheed Martin, the current managing contractor at the Oak Ridge Laboratory, is a for-profit contractor and does not qualify, under Tennessee law, for sales and use tax exemptions available to tax-exempt organizations. A UT-Battelle official told us that although they are a not-for-profit corporation, they are not a tax-exempt organization. Based on this information, the current and future managing contractors would pay similar sales and use taxes. As a result, if the SNS were built at Brookhaven by the current managing contractor, it is estimated it would cost \$2.6 million in sales and use taxes as opposed to the \$28.3 million tax estimate to construct the SNS at Oak Ridge. Should Tennessee exempt the SNS project, its contractors, and subcontractors from all sales and use taxes, there would be virtually no difference between what the sales and use tax reimbursements would be in New York and what they would be in Tennessee for building the SNS project.

#### Agency Comments

We provided a draft of this report to DOE for review and comment. DOE did not take issue with our conclusions but noted that our review focused on a very narrow issue and that when the full spectrum of costs and technical and environmental considerations is taken into account, Oak Ridge remains the optimum site. As we state in our report, we did not examine other costs that could be incurred if the SNS were to be built at another location, although we did note that differences in the costs of labor and materials could vary substantially among locations. DOE also commented that Tennessee is considering legislation to exempt the SNS from Tennessee's state taxes and that the Governor of Tennessee and the Speakers of the Tennessee House and Senate Legislature have pledged to take all necessary administrative steps to ensure "that the federal taxpayer would be no worse off for locating the project in Tennessee than it would be if the project were located elsewhere." As of the date of our report, no legislation has been enacted.

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We conducted our review from September 1999 through November 1999 in accordance with generally accepted government auditing standards. To identify a location that would represent the lowest liability for state and local sales and use taxes for constructing the SNS project among the five collaborating laboratories, we conducted literature and legislative searches to supplement the information we received from DOE and the managing contractors at those laboratories. We also interviewed Tennessee and New York state tax officials to confirm our understanding of the tax situation at the Oak Ridge National Laboratory and the Brookhaven National Laboratory. In addition, we assumed that the prime contractors at the four other collaborating laboratories would continue to manage those laboratories and thus manage the SNS project if it were built at those locations.

As arranged with your offices, we plan no further distribution of this report until 7 days after the date of this letter unless you publicly announce the contents earlier. At that time, we will send copies of this letter to Bill Richardson, Secretary, Department of Energy, and Jacob J. Lew, Director, Office of Management and Budget. We are also sending copies of this letter to the Honorable Don Sundquist, Governor of Tennessee, the Honorable John S. Wilder, Lt. Governor of Tennessee, the Honorable James O. Naifeh, Speaker of Tennessee's House of Representatives, and to Tennessee's congressional delegation. We will make copies available to other interested parties on request. If your staff have any questions about this report, please call me at (202) 512-3841. This report was prepared by Gary Boss, Michael Gilbert, Michael Sagalow, Susan Poling, and Susan Irwin.



(Ms.) Gary Jones  
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