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New Excise Tax on Certain Foreign Contractors

Section 5000C of the Internal Revenue Code (the Code) was added by the James Zadroga 9-11 Health and Compensation Act of 2010 (the Act) on January 2, 2011. This new provision imposes a 2 percent excise tax on “Federal procurement payments” made to foreign persons. A “specified Federal procurement payment” is any payment made pursuant to a contract with the U.S. Government for the provision of goods or services, provided that the goods are not manufactured or produced and the services are not provided in any country that is not a party to an international procurement agreement with the United States. The tax will be collected through withholding by the U.S. Government as payor.

It is generally understood that the “international procurement agreement” referenced in the law is the World Trade Organization’s Agreement on Government Procurement. The members of that agreement include the member states of the European Union, Canada, Taiwan, Hong Kong, Japan, Republic of Korea, and others. Many countries in and surrounding the Middle East, including Afghanistan, Iraq, and Kuwait, are not parties to the agreement, however.

The purpose of the excise tax is to offset the cost of the World Trade Center Health Program and the September 11th Victim Compensation Fund, each of which provides health care benefits and compensation to the first responders and recovery workers whose health suffered as a result of their efforts on September 11, 2001.

It is possible that the new provision could affect large U.S. government contractors with foreign suppliers. The term “foreign person” is based on the Code’s statutory definition of a United States person under Section 7701(a)(30). Therefore, a foreign subsidiary of a United States person should be treated as a foreign person when applying the excise tax.

Section 5000C is currently effective. However, the full impact of the legislation will remain unknown until the Internal Revenue

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Service issues additional guidance. For example, it is unclear how to treat subcontractors or similar service providers. It is unclear when such guidance will be issued.

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