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Alert

Government Contracts Team

To: Our Clients and Friends

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# Foreign Contractors Subject to New Tax On Contracts to Provide Services In Or Supply Goods From Certain Countries

On January 2, 2011, a new excise tax went into effect on foreign contractors that do business with the United States government and will provide goods from or services in certain countries. Although this has received some notice from tax professionals, it has largely escaped the notice of government contracting professionals, who may need to take it into account in deciding how to compete for, price, and perform their company's contracts.

The "James Zadroga 9/11 Health and Compensation Act of 2010," Pub. L. No. 111-347, 124 Stat. 3623 (codified at 26 U.S.C.A. §5000C)("the Act"), among other things, provides health care benefits and other compensation to first responders, recovery workers, and certain survivors of the September 11 attacks. These benefits are to be funded, in part, by a new excise tax imposed on any "foreign person" that "receives a specified Federal procurement payment" that is equal to two percent of that payment.

A "foreign person" is defined as "any person other than a United States person." Any business entity organized under the laws of a foreign country thus is potentially subject to the tax.

A "specified Federal procurement payment," for which the tax is levied, is defined as "any payment made pursuant to a contract with the Government of the United States" for goods or services if the goods are manufactured or produced in or the services are provided in any country that is not a party to an "international procurement agreement with the United States." The term "international procurement agreement" is not defined in the Act, but it presumably refers at a minimum to the World Trade Organization's Agreement on Government Procurement or a bilateral free trade agreement entered into by the United States and a particular nation that addresses procurement matters, although an argument can be made that it is not necessarily limited to such agreements. The bottom-line effect is that, if a contractor organized under foreign law provides goods from any country not a party to such an agreement or provides services in any country not a party to such an agreement, it could be subject to the tax.

The tax only is imposed for "any payment made pursuant to a contract with the Government of the United States." This clearly would cover payments made pursuant to a prime contract awarded to the foreign entity. It is not clear whether it would extend to subcontracts awarded by a U.S. entity to a foreign entity, although there are apparently good legal arguments based principally on the statutory language as to why it should not.

The tax is to be collected by withholding the two percent from payments that are due. Thus, with respect to prime contracts, the Federal government should indicate it believes payments under a particular contract are covered by the Act by withholding two percent from every payment. The Act also provides that the head of each "executive agency" is to "ensure that no funds are disbursed to any foreign contractor in order to reimburse the tax imposed" by the Act, effectively making the tax an unallowable cost for foreign contractors.

The potential application of this tax needs to be taken into account in a company's approach to bidding on future government contracts. For example, some U.S. corporations have established foreign subsidiaries to perform work abroad. If the subsidiary obtains Federal government contracts to provide services in a country that is not a party to an international procurement agreement or to provide goods from such a country, they effectively will find that the contract price has been reduced by two percent because the foreign subsidiary is subject to the tax, while the domestic parent, if it had been awarded and performed the contract, would not.

Note that the tax applies to <u>any</u> "foreign person," not just companies from countries that have not signed international procurement agreements. Thus, if a company organized under the laws of a country that has signed an international procurement agreement, such as France, the United Kingdom, or Australia, provides goods from or services in a country that has not signed such an agreement (potentially including countries such as Iraq and Afghanistan), it is subject to the tax. This could provide a competitive advantage to U.S. companies competing for the same work.

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