



TaxNewsFlash

United States

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Regulations: 2% tax on payments of U.S. government to foreign persons

The U.S. Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9782) under section 5000C relating to the 2% tax on payments made by the U.S. government to foreign persons pursuant to certain contracts.

The final regulations also include rules under section 6114, with respect to foreign persons claiming an exemption from the tax under an income tax treaty.

The [final regulations](#) [PDF 253 KB] will be published in the Federal Register on August 18, 2016. The preamble explains that the final regulations apply on and after a date that is 90 days after the date they are published as final regulations in the Federal Register (applicability date). However, contracting parties and acquiring agencies may rely upon the rules in the final regulations before the applicability date.

Background

Section 5000C imposes on any foreign person a 2% tax on certain payments received from the U.S. government for goods and services, and applies to payments received pursuant to contracts entered into on and after January 2, 2011.

Section 6114(a) generally requires reporting when a taxpayer takes the position that a U.S. tax treaty overrules (or otherwise modifies) an internal revenue law. Section 6114(b) provides that the Treasury Secretary may waive the reporting requirement under section 6114(a) with respect to classes of cases for which the Secretary determines that the waiver will not impede assessment or collection of the tax.

Proposed regulations were released in April 2015 under section 5000C relating to the 2% tax on payments made by the U.S. government to foreign persons pursuant to certain contracts. The IRS also released Notice 2015-35 to provide a list of qualified

income tax treaties that exempt all nationals of that country from the 2% tax imposed under section 5000C. In releasing Notice 2015-35, the IRS explained:

- The tax imposed under section 5000C applies only to specified federal procurement payments made to foreign persons, regardless of their residence, and does not apply to U.S. persons.
- The definition of “national” in U.S. income tax treaties generally includes citizens or nationals of a contracting state as well as legal persons, such as corporations, whose status as such is derived from the laws of that country.
- The tax imposed by section 5000C would not apply to payments to nationals resident in the United States.
- Not all treaty nondiscrimination articles cover taxes of every kind and description, such as the tax imposed by section 5000C. Some treaty provisions apply only to federal income taxes, in which case, the treaty article would not cover the tax imposed under section 5000C.
- In two tables, a list of countries that have qualified income tax treaties that exempt all nationals of that country from the tax imposed under section 5000C, and a list of countries that have qualified income tax treaties that exempt only individual nationals of that treaty country.

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Final regulations

The preamble explains that in finalizing these regulations, comments were received and considered and that changes were made in the final regulations to address certain comments. For instance, the final regulations include measures concerning:

- Payments made by the U.S. government to direct (prime) contractors with the U.S. government, and generally not imposing the 2% tax on a subcontractor that is not party to a contract with the U.S. government
- An exemption from the tax under section 5000C with respect to a contract entered into to obtain goods or services that are for the purpose of providing foreign humanitarian assistance
- Payments made by acquiring agencies but not made pursuant to the Federal Acquisition Regulations (FAR)
- An exemption with respect to certain personal service contracts

- The withholding certificate, and clarifying that a foreign person may use Form W-14 as its “Section 5000C Certificate” provided that all necessary information is included

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