

**VOLUME 10, CHAPTER 06: “FEDERAL, STATE, LOCAL, AND FOREIGN TAXES”****SUMMARY OF MAJOR CHANGES**

Changes are identified in this table and also denoted by [blue font](#).

Substantive revisions are denoted by an asterisk (\*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by [\*\*\*bold, italic, blue, and underlined font\*\*\*](#).

The previous version dated [August 2021](#) is archived.

<b>PARAGRAPH</b>	<b>EXPLANATION OF CHANGE/REVISION</b>	<b>PURPOSE</b>
All	Updated hyperlinks and formatting to comply with current administrative instructions.	Revision
2.9.2	Clarified policy concerning tax reporting responsibilities.	Revision

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## CHAPTER 6

**FEDERAL, STATE, LOCAL, AND FOREIGN TAXES**

## 1.0 GENERAL

## 1.1 Purpose

This chapter prescribes the financial management policy for payment of federal, state, local, and foreign taxes associated with the various types of payments addressed in this volume. It also provides the tax information reporting requirements, and associated Departmental policy, that apply to certain contract, vendor, and miscellaneous payments (including miscellaneous payments made to military and civilian employees). Tax-related policy and requirements involving Nonappropriated Fund Instrumentalities are covered in Volume 13, Chapter 7.

## 1.2 Authoritative Guidance

1.2.1. Tax Information Sources. The Federal Government's right to tax exemptions depends on the applicability of federal, state, local, and foreign tax law; tax agreements with foreign countries; items being acquired; the nature of the tax; and the type of transaction. [Federal Acquisition Regulation \(FAR\) 29](#) identifies the general tax applications on U.S. purchases, the rights to exemptions, and the methods of claiming exemptions. More specialized information regarding the applicability of various taxes not obtainable locally may be obtained from the taxing authorities themselves or through discussions with the Component's general counsel.

1.2.2. Exemptions From Certain Federal Taxes

1.2.2.1 [FAR 29.203\(a\)](#) provides that pursuant Title 26, United States Code (U.S.C.), [section 4293](#), the Secretary of the Treasury has exempted the Federal Government from the communications excise tax imposed by [26 U.S.C. § 4251](#) when the supplies and services are for the exclusive use of the United States. This does not include facilities furnished to a Government contractor. Exemptions can be made with or without the use of an exemption certificate. The installation (or issuing) contracting office is responsible for preparing tax exemption certificates.

1.2.2.2 [FAR 29.203\(b\)](#) provides that pursuant to [26 U.S.C. § 4483\(b\)](#), the Secretary of the Treasury has exempted the Federal Government from the Federal highway vehicle use tax imposed in [26 U.S.C. § 4481](#). As stated in FAR 29.203(b), the exemption applies whether the vehicle is owned or leased by the Federal Government.

1.2.2.3. [FAR 29.202](#) identifies other circumstances in which Federal manufacturers' or special-fuels excise taxes may not be imposed in contracting situations that should be recognized by the contracting officer, who then must furnish the seller an exemption certificate.

1.2.3. Policy Hierarchy. Internal Revenue Service (IRS)-published regulations take precedence over DoD policy for the resolution of tax-related issues. Components should consult with their designated legal counsel if there are legal questions or apparent conflicts between the policy provided in this chapter and the IRS regulations.

## 2.0 RESPONSIBILITIES

### 2.1 Defense Logistics Agency-Energy (DLA-Energy)

DLA-Energy is responsible for:

2.1.1. Any application for tax refunds applicable to DLA-Energy programs. If DLA-Energy supports a Federal civilian agency, then that civilian agency is responsible for collecting data needed to apply for tax refunds; and

2.1.2. Contracting for fuels, to include the use of the proper clauses concerning local tax provisions as provided in [FAR 29.4](#).

### 2.2 Military Departments and Defense Agencies

DoD Components are required to take maximum advantage of exemptions from excise taxes.

### 2.3 Contracting Officer

As outlined in FAR 29, the contracting officer is responsible for:

2.3.1. Inserting the appropriate tax clauses in contracts;

2.3.2. Soliciting prices on a tax-exclusive basis when it is known that the Federal Government as a whole, or the Armed Forces within DoD, are exempt from these taxes;

2.3.3. Contacting local and/or state taxing authorities to verify acceptance of tax exemption certificates;

2.3.4. Working with fleet card issuers to maximize excise tax reclamations (recoupment);

2.3.5. Ensuring that contractors are aware of and understand duty-free entry clause requirements; and

2.3.6. Resolving tax liability or tax exemption disputes associated with DoD contracts.

## 2.4 Contractors, Vendors, and Individual Payees

2.4.1. In accordance with [FAR 29.304](#), contractors, vendors, and individual payees requesting payment from a DoD Component may be required to take certain action regarding payment, nonpayment, refund, protest, or other treatment of state and local specified taxes. This action will be taken in consultation with the contracting officer and will be varied depending on the tax consequences, nature of the purchases, and applicable contract clauses. Any entitlement or disbursing office concerns regarding any contractor tax-related payment requests or refunds should be elevated to the contracting officer for resolution.

2.4.2. [Title 31, U.S.C. § 7701\(c\)](#) and [FAR 4.902](#) require all payees, subject to the U.S. Internal Revenue Code (IRC), doing business with the DoD to furnish their Taxpayer Identification Number (TIN) as defined by [26 U.S.C. § 6109](#) (which may be a Social Security Number (SSN), [Individual Taxpayer Identification Number](#) or [Employee Identification Number](#)). Payments are not to be authorized without a TIN or SSN on record for the required payee, except as described in paragraph 6.5.

2.4.3. If the contractor, or another payee, believes the [IRS Form 1099-MISC](#), Miscellaneous Income, [IRS Form 1099-INT](#), Interest Income, [IRS Form 1099-NEC](#), or [IRS Form 1099-C](#), Cancellation of Debt, was improperly issued or had incorrect information, they must provide written evidence for a correction to the appropriate tax office.

## 2.5 Fleet Card Issuer

The Fleet Card issuer (third-party payor) is responsible for working with DLA-Energy and [the Defense Finance and Accounting Services \(DFAS\)](#) to maximize excise tax reclamations, as rules and procedures vary by state. Generally, states require that tax reclamations be completed after payment is made. Refer to the [General Services Administration \(GSA\) SmartPay](#) website for additional Fleet Card tax information.

## 2.6 DFAS

For those entitlement systems managed by DFAS and Enterprise Resource Planning (ERP)-managed systems that have coordinated with DFAS (except for Defense Health Agency and U.S. Army Corps of Engineers, where responsibility has otherwise been assigned), DFAS is responsible for:

2.6.1. Computing all appropriate tax withholdings, making deposits to the U.S. Department of the Treasury (Treasury), and filing the appropriate tax documents with the IRS;

2.6.2. Paying excise taxes as appropriate;

2.6.3. Performing reclamation of Federal and state excise tax related to fuel purchases, based on data provided by either DLA-Energy or Fleet Card issuers. DFAS responsibilities for performing reclamation will include filing for the National Guard;

2.6.4. Recording any taxes recovered in the applicable accounting systems;

2.6.5. Reviewing payment information to determine if a payment is reportable under current IRS guidelines; and

2.6.6. For those entitlement or ERP systems not managed by DFAS, for which DFAS is the responsible disbursing activity, DFAS is responsible for:

2.6.6.1. Issuing annual instruction on requirements for submitting necessary tax reports to DFAS for distribution to the recipients; and

2.6.6.2. Coordinating the issuance of the hardcopy or electronic tax statements by the IRS-mandated timelines.

## 2.7 Office of the Staff Judge Advocate or General Counsel

These offices are responsible for providing available payment data related to all settlements of personnel cases. The document forwarded to the paying office must identify the type of payment(s) represented by the settlement (for example, compensatory damages, attorney fees, [back pay](#), or interest), as well as the dollar amount attributed to each type of payment. This information will be used to determine the proper tax reporting of the payments. These offices must also provide the information required to properly report payments to attorneys under [26 U.S.C. § 6045\(f\)](#), separate from the claims settlement payment.

## 2.8 Third-Party Payors

Third-party payors are responsible for preparing and filing [IRS Form 1099-K](#), Payment Card and Third-Party Network Transactions, for certain payments they made, even if the item(s) procured were delivered to DoD. Further, the DoD is not responsible for filing an IRS Form 1099-MISC when the covered payments are made by third-party payors.

## 2.9 Convenience Check Account Holder

2.9.1. The convenience check account holder is responsible for tax reporting for the convenience checks they issue and for obtaining a signed [IRS Form W-9](#), Request for Taxpayer Identification Number and Certification. Refer to IRS instructions for [Form 1099-MISC and 1099-NEC](#) for more detail regarding payment types that are not reportable to DFAS. As the checks are written, the account holder must capture the following check recipient data:

2.9.1.1. Payee's legal name (merchant, vendor, or individual name by which taxes are filed);

2.9.1.2 Payee's business name. If the business is classified as a sole proprietorship, then report the business (merchant) information and provide the sole proprietor's name;

- 2.9.1.3. Payee's legal mailing address (the address used to file their taxes);
- 2.9.1.4. Employer Tax Identification Number (SSN or TIN);
- 2.9.1.5. Check number;
- 2.9.1.6. Check amount;
- 2.9.1.7. Payment date (date the check is written, not the date the check is cashed);
- 2.9.1.8. A brief description of the purchase;
- 2.9.1.9. Telephone number and/or email address of the merchant; and
- 2.9.1.10. Convenience check account number.

\* 2.9.2. DFAS has tax reporting responsibilities for [certain agencies within](#) the DoD, and thus is responsible for reporting to the IRS miscellaneous [and non-employee](#) income paid to vendors/contractors. [DFAS coordinates with the GSA Smartpay contract designated bank and the account holder to obtain information to issue tax forms and report to the IRS.](#) Additional policy concerning the use of convenience checks is contained in Chapter 23.

2.9.3. The convenience check account holder is responsible for all backup withholding actions required based on the receipt of an IRS CP2100 notice (See [IRS website](#) – backup withholding). Also see paragraph 6.5 for additional information regarding backup withholding.

### 3.0 FEDERAL EXCISE TAX (FET)

#### 3.1 General

Except for exemptions provided by the [IRC](#) as set out in FAR 29, the Government must pay FET on fuel purchases. If a contract does not specify that the contract price excludes FET, then assume the contract price includes the tax and pay only the contract price. If the contract price specifically excludes the tax, then FET for fuel purchases must be billed on the invoice as a separately identified item from the contracted fuel price.

#### 3.2 Exemptions

Tax exemptions or refunds are available for DoD purchases of aviation fuel and off-highway use of gasoline and road diesel fuels. Whether or not an exemption is available, or a refund application is required, depends on where in the distribution chain the purchase was made and the IRS status of the seller of the fuel. See [IRS Publication \(Pub\) 510](#) for additional IRS guidance.

### 3.3 Refunds

Requests for refunds must be filed on an [IRS Form 8849](#), Schedule 1, Nontaxable Use of Fuels.

### 3.4 Quarterly FET Return

3.4.1. Unless notified differently by the IRS District Director, the accounting office responsible for reporting DLA-Energy activity must prepare and submit quarterly FET returns. DLA-Energy must submit a monthly report to DFAS containing the sales to taxable customers. A return must be made using [IRS Form 720](#), Quarterly Federal Excise Tax Return, for the first calendar quarter when the tax liability is incurred and each subsequent calendar quarter until a final return is filed. Final returns must be marked “FINAL” and are applicable only when no FET is owed and reportable in future quarters. See IRS Pub 510 for additional IRS guidance.

3.4.2. IRS Form 720 contains a list of the commodities and services subject to the tax and the tax rate. This form also serves as a return for all excise taxes for which quarterly reporting is required.

3.4.3. The accounting office is responsible for preparing IRS Form 720. Instructions for preparing this form are in [IRS Instructions for Form 720](#).

3.4.3.1. The IRS Form 720 filing due date is on or before April 30, July 31, October 31, and January 31.

3.4.3.2. Submit the original IRS Form 720 to the appropriate IRS Center; include the amount of taxes collected.

### 3.5 Collections for FET

3.5.1. Collections for FET are made to deposit fund accounts. Excise taxes collected must be transferred using the most current instructions received from the IRS. Generally, transfers of excise taxes are required semi-monthly and must be made electronically to the Treasury.

3.5.2. Report the amounts of FET collected and deposited for the sale of aviation fuel other than for the exclusive use of the DoD.

## 4.0 STATE AND LOCAL TAXES

### 4.1 State and Local Taxes

4.1.1. In accordance with [FAR 29.302\(b\)](#), DoD Components must assert the Government’s immunity or exemption from taxes whenever it is available, and economically feasible, to do so. State statutes identify whether the tax is levied on the seller or the purchaser. The process for seeking refunds differs from state to state. Some states accept [Standard Form 1094](#), United States Tax Exemption Form, some states have their own required forms, and other states require payment of the

tax at the time of purchase and provide a means for seeking refunds of the tax. The contracting officer will contact the local state taxing authority to verify if they accept tax exemption certificates. A blanket-type tax exemption certificate is used to obtain a U.S. Government exemption from state or local taxes in the case of continuing or numerous purchases from contractors. Payments of state and local taxes are supported under the following conditions:

4.1.1.1. When the tax is levied on the seller, the Federal Government must pay the tax as part of the purchase price unless the taxing authority provides otherwise; or

4.1.1.2. When the Government has, by contract, agreed to reimburse the contractor for taxes paid to a state or municipality.

4.1.2. Unless specifically stated otherwise in the contract, it is presumed that state and local taxes are included in the contract price. When there is a valid and binding contract covering the furnishing of supplies or services at fixed unit prices, and the contract contains no provision for the adjustment of such prices in the event of the imposition on the contractor of state taxes applicable thereto, there is no authority for the payment of any taxes over and above the unit price stipulated in the contract.

## 4.2 Taxes Involving Fuel Purchases

DLA-Energy is responsible for supplying applications for tax refunds on fuel purchases for both service station and bulk purchases of fuel. Contracting officers should coordinate with DLA-Energy on the applicability and reimbursement of state and local taxes pertaining to diesel fuels and gasoline purchases.

## 4.3 Leases and Purchases

In accordance with [FAR 29.302\(a\)](#), generally, purchases and leases are immune from various state and local taxes. This determination is a legal question and requires consultation with agency counsel. FAR 29.4 references the different contract clauses concerning state and local taxes that may be included in contracts on leases and rentals.

## 5.0 CUSTOMS DUTIES

### 5.1 U.S. Customs Duties on Foreign Purchases

5.1.1. Duty-Free Purchases. The DoD Components can make emergency purchases of war materials abroad. This material will be admitted free of duty. The applicability of customs duties is governed by the contract and actions of the contractor and contracting officer in accordance with [FAR 25.9](#). Federal acquisition policy in FAR 25.9 states that agencies must pursue and use any exemptions allowed when the anticipated savings to appropriated funds will outweigh the administrative cost associated with processing the required documentation. [Defense Federal Acquisition Regulation Supplement 225.9](#) provides more specific Departmental policy and requirements of the administrative contracting officer (ACO) in issuing duty-free entry

certificates, identifying exempted supplies, and performing other formal entry and release procedures for the foreign items procured under a prime contract.

5.1.2. Payment of Custom Duties. If the importation is not determined to be duty-free, then the duty must be charged to the same appropriation/fiscal year used to fund the purchase, even though the importation and purchase may be in different fiscal years. Expired funding is available for such obligation "adjustments" as stated in Volume 3, Chapter 10. The amount due will be generated based on the classification of imports by Customs and Border Protection. Payment vouchers must be prepared to show the payment amount, annotated with the source and calculated amount of the duty, with remittance addressed to the Collector or Deputy Collector at the port of entry. However, prior to payment, the entitlement office must obtain the ACO's approval to ensure the amount of the customs duties is not already covered in the price of the contract or exemption certifications have been issued to exempt the procured items from customs duties.

## 5.2 Customs Exemptions for American Imports and Purchases in Canada for Joint Defense Program

5.2.1. General. The Government's imports and purchases from other countries are exempt from Canadian import duties and taxes when used for joint defense projects in Canada.

5.2.2. Refund or Remission of Taxes. Goods purchased in Canada by or for the United States, or by the Canadian Commercial Corporation, are governed by concessions when U.S. funds expended are intended for joint Canadian-U.S. projects in Canada or when the goods will become and remain U.S. property. See Defence Production and Development Sharing Remission Order [Consolidated Regulations of Canada, c. 755](#). The concessions permit refund or remission in certain circumstances, including:

5.2.2.1. Sales taxes paid on goods, other than those for resale, to members of the U.S. Armed Forces or civilian personnel for private use;

5.2.2.2. Excise taxes, including the stamp tax on checks. Items for resale to members of the U.S. Armed Forces or civilian personnel for private use are not exempt from stamp taxes or excise taxes; and

5.2.2.3. Customs duties paid on import goods when used, directly consumed, processed, or attached to items or goods manufactured in Canada and sold to the U. S. Government for use with joint Canadian-U.S. projects.

## 6.0 MISCELLANEOUS

### 6.1 Payments in Lieu of Taxes

Issues involving the payment of taxes are complex and should be referred to the activity's servicing legal office.

6.1.1. Charges by state or local governments for services levied on Federal Government entities or their contractors, which are not imposed on residents or nonfederal tax-exempt entities, where the cost of service is borne by the general tax revenues, are the nature of a tax to which the DoD is immune.

6.1.2. A reasonable charge by a political subdivision based on the “quantum” of direct service furnished, and which is applied equally to all property tax exempt entities, is not considered a tax against the DoD, even though the services are furnished to taxpayers without a direct charge, provided the political subdivision is not required by law to furnish the service involved without a direct charge to all located within its boundaries.

6.1.3. Payments are permitted in lieu of taxes to municipalities that have lost tax revenue due to the transfer of plants to Government Components, only when authorized by the Congress. Payments in lieu of taxes are not authorized if the property transferred was never on municipality tax rolls and municipal services had never been furnished.

## 6.2 Foreign Taxes

U. S. Government purchases in a foreign country are not exempt, in general, from taxes and custom duties when imposed by the foreign country. The Status of Forces or other government tax or trade agreements may provide exemptions. The Component’s legal counsel should be consulted regarding the applicability of these agreements to their individual circumstances. [FAR 29.402](#) provides specific clauses pertaining to foreign taxes that may be in contracts.

## 6.3 Taxes on Arms and Ammunition

In accordance with [10 U.S.C. § 2385](#), Federal taxes may not be imposed on the sale or transfer of firearms, pistols, revolvers, shells, or cartridges when such articles are purchased with funds appropriated for a military department.

## 6.4 Environmental Assessments

If an environmental assessment is levied by a local government, and it represents a fee, then the payment is authorized. If the assessment appears to be a tax, and its legality is questionable, then the payment is not authorized. The Component’s legal counsel should be consulted to determine whether payment should be made.

## 6.5 Backup Withholding

6.5.1. In most instances, pursuant to [31 U.S.C. § 3325](#), DoD may not make a payment without a valid TIN. If payment is appropriate without a TIN and a signed IRS Form W-9, and no exception to backup withholding applies, backup withholding must occur. Backup withholding requirements are enforced on a payment-by-payment basis, regardless of payment size. When an individual or entity has not provided a TIN and a signed IRS Form W-9 as described above, the backup withholding requirements, as described in [26 U.S.C. § 3406](#), are applicable. Because of

the TIN requirement imposed by 31 U.S.C. § 3325, backup withholding within DoD should be extremely rare.

6.5.2. Backup withholding requirements are separate from the reporting thresholds that apply to most IRS Form 1099 reporting. Backup withholding is applied to the principal payment only, to exclude such charges as transportation charges or interest. Payments that are not subject to reporting on the IRS Form 1099, as set forth in subparagraph 7.3.2, are not subject to backup withholding.

6.5.3. The [paying office will deposit the backup withholding with the IRS](#). The paying office will generate an [IRS Form 945](#), Annual Return of Withheld Federal Income Tax, for the IRS. Additional guidance is available in [IRS instructions for Form 945, IRS Pub 15, \(Circular E\)](#), “Employer’s Tax Guide,” and [IRS Pub 1281](#), “Backup Withholding for Missing and Incorrect Name/TIN(s).”

6.5.4. DoD activities must perform backup withholding on reportable payments when the following conditions exist:

6.5.4.1. The IRS informs the paying office that the payee provided an incorrect TIN and reportable payments totaling \$600 or more during the calendar year,

6.5.4.2. An information return was required concerning the payee for the preceding calendar year, or

6.5.4.3. Backup withholding was required from the payee for the preceding year.

## 7.0 FEDERAL TAX REPORTING

### 7.1 General

7.1.1. At the end of each calendar year, payment or entitlement offices are required to report certain payments to the IRS. The reporting requirements are established by [26 U.S.C. § 6041](#), [26 U.S.C. § 6041A](#), 26 U.S.C. § 6045(f), [FAR 4.904](#), and current IRS instructions/guidelines. Payment or entitlement offices must provide the recipients (payees) with an IRS Form 1099 by the date specified by the IRS (See [IRS reporting due dates](#)).

7.1.2. There are various payments made to military members and civilian employees that are subject to IRS for [IRS Form W-2](#), Wage and Tax Statement, reporting (e.g., military award payments). Some of these payment types may require tax withholding and will be reported on the IRS Form W-2. These payments are required to be paid by the appropriate system for accurate withholdings to be applied and reported on the annual IRS Form W-2 by the date specified by the IRS (see IRS reporting due dates). Payment through a vendor pay office is only authorized if the appropriate withholdings are computed, included, and presented for payment to the vendor pay office. At the end of each calendar year, payment or entitlement offices are required to report these payments via Form W-2 according to current Social Security Administration/IRS guidelines.

## 7.2 Tax Reporting

7.2.1. Each DoD Component is responsible for the preparation of an IRS Form 1099 on its contract or vendor payments for applicable services (specified in paragraph 7.3) that total \$600 or more, or royalties of \$10 or more, in a calendar year to a single person or business entity (partnership, sole proprietor, or corporation), unless an exception applies. For DFAS-serviced Components, DFAS will prepare, print, and distribute the hard copy of the IRS Form 1099 to the vendor/contractor/payee and forward the same information to the IRS. If an IRS Form 1099 is required to be corrected, then the paying office that maintains the underlying payment record provides the information necessary to effect the correction. If the vendor/contractor/payee believes the IRS Form 1099 was improperly issued or had incorrect information, then the recipient must provide the written evidence needed for correction.

7.2.2. Payment data in various payment systems, for the same contractor, must be consolidated to determine if an entity was paid more than \$600 for reportable payments.

7.2.3. IRS Form 1099-MISC is not required for purchase cards and centrally-billed travel paid for using a government credit card.

7.2.4. DFAS will not make a determination of independent contractor or employee status for tax purposes when payments are made to individuals. That determination is at the discretion of the contract-issuing activity. If there is a question, then the contract-issuing activity, through its chain of command, will submit an [IRS Form SS-8](#), Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, to the IRS Associate Chief Counsel (tax exempt and government entities) for a determination. See [IRS Pub 1779](#), “Independent Contractor or Employee,” for additional information.

## 7.3 IRS Form 1099 Information Reporting

7.3.1. Payments Subject to Reporting. Certain contract and vendor payments are subject to IRS Form 1099 reporting in accordance with IRS regulations/guidelines.

7.3.1.1. General Rule. Payments are aggregated for the taxable year for:

7.3.1.1.1. Business entities: Sole proprietors, partnerships, and corporations, with some exceptions;

7.3.1.1.2. Corporations providing medical and health-care services that are not otherwise exempt from taxation under [26 U.S.C. § 501\(a\)](#);

7.3.1.1.3. Canceled debts; and

7.3.1.1.4. Interest (including [Title 5, Code of Federal Regulation, Part 1315](#), Prompt Payment) to individuals, sole proprietors, and partnerships. Corporations are exempt from interest reporting.

7.3.1.2. Payment for Services. Payment or compensation for services rendered, including medical or health-care services and contractual legal services, is subject to IRS Form 1099 reporting, unless the payment **is to an employee and** should be reported on an IRS Form W-2. This reporting requirement applies regardless of whether payment is issued to an individual, a sole proprietorship, a partnership, or corporation. The requirement does not apply when a payment is made to a hospital or extended health-care facility that is exempt from taxation under 26 U.S.C. § 501(a), or to a hospital or extended health-care facility owned and operated by the U.S. or an agency or instrumentality of the **United States**. This reporting rule also applies to payments issued to U.S. corporations, paid in U.S. dollars, for service contracts executed in foreign countries.

### 7.3.1.3. Payments for Taxable Settlements

7.3.1.3.1. Generally, payments for personnel claims, Equal Employment Opportunity actions, and grievances represent taxable income and should be reported on an IRS Form 1099, but may be reported on an IRS Form W-2 depending on the classification of the settlement categories. This includes amounts paid in settlement, damages for nonphysical injuries or sickness (such as employment discrimination or defamation), liquidated damages, and punitive damages. Amounts paid on account of personal physical injury or physical sicknesses, however, are not taxable and are not reported on an IRS Form 1099.

7.3.1.3.2. Compensatory damages received based on emotional distress or injury that are attributable to a physical injury or physical sickness are not taxable and not reported on an IRS Form 1099, to the extent that the amount paid does not exceed the amount paid for medical care for the emotional distress. Damages paid on account of emotional distress, including physical symptoms such as insomnia, headaches, and stomach disorders, which are not attributable to a specific physical injury or physical sickness, are reportable.

7.3.1.3.3. In cases where the amount to be paid to the complainant represents back pay, and the claim originates with a DoD activity whose civilians are paid by DFAS, the claim must be forwarded to a civilian pay office for payment and issuance of an IRS Form W-2. DoD activities must forward claims representing back pay to their supporting payroll office.

7.3.1.3.4. The office forwarding personnel claims, as described in Chapter 12, for payment, such as taxable settlement awards, is responsible for providing information with the settlement documents that are required for tax reporting. All settlement payments are presumed to be taxable unless otherwise indicated in the settlement agreement or they meet one of the specific categories that are nontaxable.

7.3.1.4. Gross Proceeds Paid to an Attorney. The total amount paid to an attorney for legal services, other than contractual legal services, must be reported on an IRS Form 1099 as required by 26 U.S.C. § 6045(f). The term “attorney” includes a law firm or other provider of legal services, such as a corporation. This reporting requirement applies, regardless of whether or not legal services are provided to the Government, and if the attorney is the sole payee. In the case of payment by check, payment is considered to be made to the attorney or law firm if the attorney or law firm is named the sole, joint, or alternate payee. A need to issue two IRS Form 1099s on a

single payment may occur. In this case, issue an IRS Form 1099 to the complainant and another IRS Form 1099 to the attorney. Information that must be provided by the office forwarding the claim for payment includes, but is not limited to: payee name(s), payee TIN, amount paid, payee address(es), and settling activity identification.

7.3.1.5. Vendors in U.S. Territories. Service payments to vendors located in Puerto Rico, Guam, American Samoa, Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands are subject to IRS information reporting.

7.3.2. Payments Not Subject to Reporting. The following classes of contract and vendor payments are not subject to IRS Form 1099 reporting:

7.3.2.1. Payment of bills for merchandise, transportation, freight charges, telegrams, telephone, storage, and similar charges;

7.3.2.2. Payments subject to reporting on an IRS Form W-2 related to compensation paid to DoD employees or service members;

7.3.2.3. Payments of rent, if made to a real estate agent;

7.3.2.4. Payments to Government employees as an allowance or reimbursement for traveling or associated expenses, including claims for damaged household goods;

7.3.2.5. Payments made as an award to an informer or similar payments;

7.3.2.6. Payments made to a Government agency, political subdivision, or instrumentality thereof; and

7.3.2.7. Payments to organizations that are exempt from taxation under 26 U.S.C. § 50 (a).

#### 7.4 Debt Actions Subject to IRS Form 1099-C

7.4.1. Federal agencies are required to report the cancellation of each debt to an individual, sole proprietor, partnership, or corporation. Debts forgiven via a waiver or remission are not issued an IRS Form 1099-C. The term “debt” includes the principal owed, interest, penalties, administrative costs, and fines. If, however, interest is included in the amount reported on the IRS Form 1099-C, then it must be listed separately on the form. A debt is considered to be canceled on the date that the authorized individual approves the termination of the debt-collection process.

7.4.2. The cancellation of the debt is reported on IRS Form 1099-C, regardless of whether the debtor is required to report the debt as income. A copy of the IRS Form 1099-C must be provided to the debtor by the date specified by the IRS (See IRS reporting due dates). If payment is received on a previously canceled prior year debt, then there is no requirement to file an additional or corrected IRS Form 1099-C.

## 7.5 Payments to Individuals Subject to IRS Form W-2 Reporting

7.5.1. General. As discussed in Chapter 12, various payments are issued by DFAS to, or on behalf of, DoD employees and military members. Payments may be subject to tax withholding and tax reporting (Federal and state) on an IRS Form W-2.

### 7.5.2. Cash Awards to Military Members

7.5.2.1. Cash awards to military members for disclosures, suggestions, inventions, and scientific achievements are subject to the withholding of Federal and state income taxes, as cited in Chapter 12 paragraph 2.14.3 and Volume 7A, Chapter 44, paragraph 2.1. In accordance with Volume 7A, Chapter 45, paragraph 2.2, cash awards are not subject to Federal Insurance Contributions Act (Old Age, Survivors, and Disability Insurance/Medicare) withholding. Certain Combat Zone Tax Exclusions (CZTE) may apply. Information on the CZTE is available in [IRS Pub 3](#), “Armed Forces’ Tax Guide,” and Volume 7A, Chapter 44, Withholding of Income Tax.

7.5.2.2. For purposes of issuing an IRS W-2, DFAS will withhold taxes and will issue an IRS Form W-2 by the date specified by the IRS (see IRS reporting due dates). See subparagraph 7.1.2 for additional information.

## 7.6 Filing Information Returns With the IRS

### 7.6.1. Filing Requirements

#### 7.6.1.1. Forms Required

7.6.1.1.1. When filing manual (paper) IRS Form 1099s, [IRS Form 1096](#), Annual Summary and Transmittal of U.S. Information Returns, must be used to transmit and summarize payment information. It serves as a cover sheet for one or more individual reports. IRS Form 1096 is obtained through the [IRS Forms, Instructions and Pubs](#) website.

7.6.1.1.2. A separate IRS Form 1099 must be completed for each entity concerned, and all are covered by one IRS Form 1096. IRS Form 1099s are obtained through the IRS Forms, Instructions and Pubs website.

7.6.1.2. Distribution of Report. The IRS Form 1096 is to be filed using the address listed on the form, and the IRS Form 1099 is to be filed according to [IRS Pub 1220](#), “Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G.”

7.6.1.3. Electronic Filing. The [IRS Form 4419](#), [Revise Existing Transmitter Control Code \(TCC\) for Application for Filing Information Returns Electronically \(FIRE\)](#), must be used to receive IRS approval to transmit electronically. When filing 250 or more IRS Form 1099 returns in a single report, filings are done electronically and are required to be filed by the date specified by the IRS (see IRS reporting due dates). These electronic filing procedures are published annually in IRS Pub 1220.

## 7.6.2. Records Retention

7.6.2.1. Activities preparing information returns must have the ability to reconstruct the data or records used to prepare the IRS Form 1099. The data or records must be retained for at least three calendar years, plus the current calendar year, after filing the information return. See [IRS General Instructions for Certain Information Returns](#). These records permit an audit trail that will substantiate the amount(s) reported by showing all relevant payments, to include payments from multiple contracts. The retention period for IRS Form 1099-C, or backup withholding data, is four calendar years after filing the information return. The issuing location must maintain a copy of information returns or be able to recreate the tax document.

7.6.2.2. Documentation supporting tax-related financial transactions reported in the Component's financial statements needs to be retained in accordance with Volume 1, Chapter 9. The documentation retained must be of sufficient quality to allow an independent third party, such as an auditor, to confirm the computation of the tax-related transaction posted in the accounting system and reported on the financial statements.

## 8.0 TAX ON CERTAIN FOREIGN PROCUREMENT PAYMENTS

### 8.1 General

In accordance with [Title 26 U.S.C. § 5000C](#) and implementing regulations such as [FAR 29.402-3](#), a 2% tax will apply to certain foreign procurement payments, unless one of the exemptions in paragraph 8.3 applies. The tax, effective with contracts issued after June 5, 2020 (date of FAR final rule), is identified by the inclusion of [FAR 52.229-12](#) in the contract, and requires paying agents to withhold up to 2% of applicable payments.

### 8.2 Background

Section 301 of the James Zadroga 9/11 Health and Compensation Act of 2010 ([Public Law 111-347](#)), added section 5000C to the IRC. [Title 26 U.S.C. § 5000C](#), and its implementing regulations at [26 CFR 1.5000C1 through 1.5000C7](#), imposed, unless exempted, a 2% excise tax on the amount of a specified Federal procurement payment on any foreign person receiving such payment. Title 26 CR 1.5000C-1(c) defines the term "specified Federal procurement payment" as any payment made pursuant to a contract with the U.S. Government for goods or services if the goods are manufactured or produced, or the services are provided, in any country that is not a party to an international procurement agreement with the United States.

### 8.3 Exemptions

Exemptions from the tax may be identified at various stages of the procurement or payment process.

8.3.1. Exemptions Identified Prior to Contract Solicitation. In accordance with FAR 29.402-3, a contracting officer will include the solicitation provision [FAR 52.229-11](#), unless one of the following exceptions applies:

8.3.1.1. Acquisitions using simplified acquisition procedures that do not exceed the simplified acquisition threshold (as defined in [FAR 2.101](#));

8.3.1.2. Emergency acquisitions using the emergency acquisition flexibilities defined in [FAR 18](#);

8.3.1.3. Acquisitions using the unusual and compelling urgency authority per [FAR 6.303-2](#);

8.3.1.4. Contracts with a single individual for personal services that will not exceed the simplified acquisition threshold on an annual calendar year basis for all years of the contract; or

8.3.1.5. Acquisitions if the requiring activity identifies that the requirement is for certain foreign humanitarian assistance contracts.

If one or more of the above exceptions exists, the contracting office will not include the FAR provision in 52.229-11 and clause 52.229-12 in the solicitation and contract, and the resulting contractual payments will not be subject to the tax withholding.

8.3.2. Exemptions Identified by the Vendor During Contract Proposal or Invoicing. FAR provision 52.229-11 requires the bidder/offeror to identify whether they are a foreign person/entity. The provision also requires that, if the bidder/offeror is a foreign person/entity, to identify whether they are claiming a full exemption, partial exemption, or no exemption from the tax by submitting an [IRS Form W-14](#), Certificate of Foreign Contracting Party Receiving Federal Procurement Payments.

8.3.2.1 If the vendor claims a full exemption in their offer, they are not required to submit an IRS Form W-14 with each invoice, and no withholding by the paying agent for the 2% excise tax will be required. Per FAR clause 52.229-12, if circumstances change during the performance of the contract and the full exemption no longer applies, the vendor is required to notify the contracting officer and begin submitting an IRS Form W-14 with each invoice.

8.3.2.2. If the vendor only claims a partial exemption, or no exemption, from the tax with their offer, then the vendor is required, in accordance with FAR clause 52.229-12, to submit an IRS Form W-14 with each invoice, indicating the amount or percentage of the invoice that is exempt from the tax. The excise tax withholding is applied at the payment level, not at the contract level. The vendor must revise each IRS Form W-14 submission to reflect the exemption (if any) that applies to that particular invoice.

8.3.2.3. If the vendor has only claimed a partial exemption, or no exemption, in their offer, and a Form W-14 is not submitted with an invoice, the default withholding percentage is 2% for that payment request.

## 8.4 Withholding Requirements

8.4.1. Unless the vendor has claimed a full exemption as part of their bid/offer, paying agents will withhold the tax from invoices received based on the information provided by the vendor on the IRS Form W-14 accompanying each invoice. This will typically be 2% of the invoice amount unless the vendor has claimed a partial exemption on the W-14 (e.g., only a portion of the goods were manufactured, or services provided, in a country that has an international procurement agreement or tax treaty with the [United States](#)).

8.4.2. Per FAR clause 52.229-12(d), the Government will withhold a full 2% of each payment unless the vendor claims an exemption. If the vendor enters a ratio in line 12 of the IRS Form W-14, the result of line 11 divided by line 10, the Government will withhold from each payment an amount equal to 2% multiplied by the contract ratio. If the vendor marks box 9 of the IRS Form W-14 (rather than completing lines 10 through 12), the vendor must identify and enter the specific exempt and nonexempt amounts in Line 15 of the IRS Form W-14. The Government will then withhold 2% only from the nonexempt amount.

8.4.3. If the vendor has not claimed a full exemption during their offer, and a Form W-14 is required but not provided with an invoice, the default withholding will be 2% of the invoice amount.

## 8.5 Responsibilities

8.5.1. Contracting Officer. The contracting officer is responsible for identifying to the paying agent whether or not the contractual payments are subject to the 2% Foreign Excise Tax via inclusion of the appropriate FAR provisions and clauses (52.229-11 and 52.229-12), as well as identifying, in the contract, whether the vendor has claimed a full exemption in its original offer/proposal.

8.5.2. Vendor/Payee. The vendor/payee is responsible for submitting an IRS Form W-14 with each payment request if they have identified in their proposal that: 1) they are a foreign person/entity, and 2) that they have not claimed a full exemption from the tax in their original offer/bid.

8.5.3. Paying Agent. The paying agent is responsible for the following:

8.5.3.1. Withholding the 2% Foreign Excise Tax in accordance with the IRS Form W-14 that the vendor/payee submits with each payment request;

8.5.3.2. Filing the appropriate reports as identified in paragraph 8.9 to report tax withholdings to the IRS, and;

8.5.3.3. Submitting the withheld funds to the IRS as prescribed in paragraph 8.9.

8.5.3. Acquiring Agency/Paying Agent. Every effort must be made by the acquiring agency and paying agent to identify, withhold, and report applicable tax withholdings to the IRS.

However, per IRS guidance, if the acquiring agency fails to withhold the tax, then the foreign contracting party must file a U.S. income tax return and pay the tax due. The acquiring agency, or the paying agent, is not liable for any tax not withheld (see the [U.S. Government Reporting](#) section on the IRS webpage).

## 8.6 Disputes

In accordance with FAR provision 52.229-11(c), any disputes regarding the imposition and collection of the 26 U.S.C. § 5000C tax are adjudicated by the IRS as the 26 U.S.C. § 5000C tax is a tax matter, not a contract issue. If a vendor disputes a withholding of the 2% Foreign Excise Tax, the vendor should be referred to the IRS to address the matter.

## 8.7 Refunds for Over-withholdings

8.7.1. Refunds of over-withholdings claimed by a vendor may not be refunded by the paying agent. In accordance with 26 CFR 1.5000C-2(e), if the foreign contracting party (payee) discovers that amounts withheld on prior payments were in excess of the amount required to satisfy its tax liability under section 5000C, the foreign contracting party may request the acquiring agency to decrease the amount of withholding on future payments for which withholding is required under section 5000C. The request must be in writing, signed under penalties of perjury, contain the amount by which the foreign contracting party requests to increase or decrease future amounts withheld under section 5000C, and explain the reason for the request.

8.7.2. Upon receipt of a request in writing, acquiring agencies may decrease the amount of withholding on subsequent payments made to the foreign contracting party that are otherwise subject to withholding under section 5000C, provided that the payment for which the decrease is applied is made on or before the end of the applicable tax year, with respect to the payment for which the over-withholding occurred.

## 8.8 Payments on Classified Contracts

8.8.1. Payments against classified contracts are not exempt from the withholding of the 2% Excise Tax. However, an acquiring agency/paying agent must determine if the reporting of such tax/withholdings against classified contracts will compromise national security. If so, the reporting of such information may be scaled back or eliminated.

8.8.2. In accordance with 26 CFR 1.5000C-3(c)(2), an acquiring agency is not required to report information otherwise required by 26 CFR 1.5000C on [IRS Form 1042-S](#), Foreign Person's U.S. Source Income Subject to Withholding, for payments made pursuant to classified or confidential contracts, unless the acquiring agency determines that the information reported on the Form 1042-S does not compromise the safeguarding of classified information or national security.

## 8.9 Reporting/Submission of Withheld Funding to IRS

The paying agent/office is responsible for filing the following reports and submitting withheld taxes to the IRS.

### 8.9.1. Reporting

8.9.1.1. [IRS Form 1042](#), Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, is an annual form used to report all/aggregate funds withheld by an acquiring agency. This form must be filed annually by March 15 of the year following payment.

8.9.1.2. IRS Form 1042-S is an annual form, broken down and submitted for each vendor/payee for which tax withholdings have occurred. The form is not required to be prepared/submitted with each deposit made to the IRS because the IRS' [Electronic Federal Tax Payment System](#) has a field for remitters to identify what/who the deposit pertains to.

8.9.1.3. The IRS 1042-S is only required to be filed if withholdings have occurred. If no withholdings have occurred for a particular vendor/payee, regardless of the reason, then no Form 1042-S is required. The reporting requirement ties directly to actual withholding that has occurred.

8.9.1.4. The Gross Income Subject to Withholding to be included on the Form 1042-S is the total of the invoiced amounts, which are actually subject to the tax (i.e., it excludes the portions of billings that are exempted based on the vendor's W-14). As an example, if the vendor submits an invoice for \$500,000, and their attached Form W-14 shows that 50% of the services are exempt because they were provided in a country that has an international tax treaty with the [United States](#), then only 50% of the invoice (\$250,000) would be taxed at the 2% rate. Thus, the \$250,000 would be reported on the vendor's Form 1042-S at the end of the tax year as Gross Income Subject to Withholding (along with any other taxed invoices the vendor had throughout the year), and \$5,000 ( $\$250,000 \times 2\%$ ) would be withheld from the payment and be reported as Taxes Withheld (along with any other taxes withheld for the vendor throughout the year).

### 8.9.2. Filing/Submission of Withheld Funds to IRS

8.9.2.1. Funds withheld by paying agents must be submitted/deposited to the IRS via the Electronic Federal Tax Payment System in the timeframes required by 26 CFR 1.5000C-3(b).

8.9.2.2. The frequency of depositing withheld amounts depends on whether the paying agency has other [26 U.S.C. Chapter 3](#), withholding and depositing requirements.

8.9.2.3. If the paying agent does not have any other [26 U.S.C. Chapter 3](#) withholdings, they will make monthly deposits of the 2% tax withholdings on a monthly basis by the 15th of the following month.

8.9.2.4. If the paying agent has other [26 U.S.C. Chapter 3](#) withholdings, the frequency will be dependent on the amounts of withholdings that need deposited (weekly, bi-weekly, or monthly).

## 8.10 Document Retention

The paying agent withholding applicable taxes will retain all documentation supporting the contract payments, and all tax-related information supporting withholdings, in accordance with Volume 1, Chapter 9, Figure 9-1. This includes any documentation supporting the determination of whether to withhold, how much to withhold, and what was actually withheld, such as contracts, invoices, receiving reports, payment/Electronic Funds Transfer information, the vendor's W-14, Forms 1042 and 1042-S, and IRS Form W-9, Request for Taxpayer Identification Number and Certification.