USAID PROCUREMENT EXECUTIVE
PROCUREMENT EXECUTIVE'S BULLETIN (PEB) NO. 2017-02
SUBJECT: **EXEMPTIONS AND ALLOWABILITY OF HOST-COUNTRY TAXES**

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1. Purpose

The purpose of this PEB is to provide reference information, considerations, and best practices to support a Contracting Officer ("CO") or Agreement Officer ("AO") in analyzing and resolving issues related to allowability of the cost of host-country taxes.

2. Background

While generally not allowable, in some circumstances a CO/AO may determine that a host-country tax on development assistance is an allowable cost despite the existence of an exemption. USAID contractors and recipients are required to avail themselves of these exemptions. Despite efforts undertaken by the contractor or recipient to pursue the host-country tax exemption or refund, the host-country government may not grant the exemption or refund. In some situations, the CO/AO may determine that an exemption cannot be reasonably obtained and is not available for purposes of allowability. In such a circumstance, the tax may be charged to the award if the cost is otherwise allowable, allocable, and reasonable.[1]

3. Discussion

The allowability of a tax payment in cases where an exemption or reimbursement is available depends in part on whether the contractor or recipient used its best efforts to invoke the exception or seek reimbursement. It is the responsibility of the contractor or recipient to show that it availed itself of reasonably available processes, administrative or legal, for invoking the exception, obtaining a reimbursement, or otherwise challenging the tax assessment. USAID may request relevant documentation to verify that the contractor or recipient properly followed local requirements for reimbursement or to invoke the exception.

The allowability determination will necessarily be based on the terms of a bilateral agreement

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[1] Note that a determination of allowability is separate from the requirement for the contractor or recipient to file an annual report on taxes paid to foreign governments. *See* 48 C.F.R. § 752.229-71, Reporting of Foreign Taxes; ADS 303maa (for U.S. nongovernmental organizations ("NGOs"); ADS 303mab (for non-U.S. NGOs).

between the U.S. Government and the host country,[2] and/or the laws and policies of the host-country government. It should be made considering any USAID mission-specific policies (*e.g.*, Mission Orders) and/or procedures concerning foreign tax allowability and after consultation, as appropriate, with cognizant legal counsel (the Resident Legal Officer ("RLO") or Office of General Counsel ("GC")).

Applicable Cost Principles: The allowability of taxes is governed by the applicable cost principles, either 2 C.F.R. Part 200, Section 470 or FAR 31.205-41, depending on the type of organization and award.[3] Although there are some differences between the applicable provisions (see Table 1, *Cost Principle Excerpts*, below), both sets of rules establish that a foreign tax for which there is an exemption available either directly to the organization, or indirectly based on an exemption available to the U.S. Government, is not allowable.[4] If there is no exemption directly or indirectly available to the organization, the tax may be allowable.

Bilateral Agreements: U.S. law requires that USAID include provisions in its framework bilateral agreements allowing exemptions or reimbursements for foreign taxes on U.S. development assistance.[5] These provisions are necessary because U.S. law cannot grant an exemption from another country's tax laws -- only the host-country government can grant an exemption from its laws.[6] As a result, most exemptions from taxes on development assistance are based on the specific terms of a bilateral agreement. Accordingly, the process for invoking an exemption or seeking reimbursement varies based on the terms of the bilateral agreement, as well as the law and practices of the host government.

Best Practices: It is not possible at a global level to define the specific steps that must be taken to establish that the contractor or recipient used its best efforts to invoke the exception or seek reimbursement. Whether a contractor or a recipient has met its burden in establishing allowability may depend on a variety of factors specific to the country. However, as discussed below, there are general steps that M/OAA recommends that COs and AOs consider when making a determination concerning the allowability of foreign taxes. Those steps are as follows:

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[2] Underlying all USAID development assistance activities conducted within the territory of a foreign country is at least one international agreement that establishes the terms under which the United States provides such assistance. While these agreements are often a "Framework Bilateral Agreement," as defined in ADS Chapter 349, International Agreements, the term "bilateral agreement" is used in this PEB broadly to refer to the underlying agreements between the United States and the host country that provide the basis for exempting USAID development assistance from taxation.

[3] *See* 2 C.F.R. § 200.401, Application, and FAR Subpart 31.1, covering application of the FAR cost principles to grants, cooperative agreements, and contracts and organizations by type.

[4] A Directly Eligible/Available exemption is one that a USAID contractor or recipient can obtain directly and on its own irrespective of the extent to which its activities in country are financed by USAID. By contrast, an Indirectly Eligible/Available Exemption is one that a USAID contractor or recipient can obtain because a tax exemption has been granted to USAID and the USAID-financed activities of its contractors and recipients through a bilateral agreement with the host country.

[5] *See* Pub. L. 113-76, 128 Stat. 5, § 7013 (Section 7013 of the 2014 State Foreign Operations Appropriations Act (SFOAA)).

[6] *See* ADS Chapter 155 - "Department of State Section 579 Implementation - Taxation of U.S. Foreign Assistance." Note that Section 579 has been replaced by SFOAA Section 7013.

a. **Review the Terms of the Award.** Review the terms of the contract, grant, or cooperative agreement to assess whether specific provisions address tax allowability. Award terms should include any advance agreements negotiated regarding taxes.

b. **Review the Bilateral Agreement and USAID Mission Guidance.** Review the bilateral agreement and any USAID Mission guidance concerning the allowability of taxes. Foreign tax payments may be allowable if USAID does not have a bilateral agreement relating to taxes or reimbursement is made only directly to the U.S. Government.

- *Mission Guidance.* Many USAID Missions have guidance concerning the process for invoking an exemption and when taxes will be deemed allowable. This guidance will typically provide specific steps that a contractor or recipient must take to invoke the exemption or seek reimbursement. Since this guidance is tailored to the host country's taxation and legal systems or to arrangements between USAID and the host country, it provides a more precise mechanism for determining allowability. As a best practice, M/OAA recommends that Missions routinely facing foreign tax allowability issues develop such guidelines.

c. **Determine Whether a Tax Exemption Applies.** In consultation with legal counsel as appropriate, consider whether the foreign tax is covered by an exemption or if the contractor or recipient is entitled to a reimbursement under the bilateral agreement. Relevant considerations include:

- *Whether the bilateral agreement covers the award*. There may be a tax exemption in the bilateral agreement, but the exemption does not cover the contractor's or recipient's award. In some countries, USAID's tax exemptions arise under a specific Strategic Objective Agreement (SOAG) or Development Objective Agreement (DOAG) and only cover assistance provided under that agreement. Thus, assistance provided under a USAID/Washington or Regional Mission-funded award may not be covered by the exemption.

- *Whether the exemption covers the specific tax.* USAID may have a bilateral agreement with a particular country that exempts certain local taxes, but the tax exemption does not cover the particular tax, levy, duty, or fee. For example, the bilateral agreement may exempt USAID from taxes on goods, but not services. Exemptions typically do not cover taxes on income or profit imposed on citizens of the host country or entities organized in that country. If the bilateral agreement was negotiated many years ago, a host government may contend that it does not cover a newly instituted tax, such as a value-added tax ("VAT"). Alternately, the host country may apply the exemption to its federal taxes, but not local or provincial taxes. Similarly, taxes assessed by other countries would not fall under the exemption.

- *Whether another exemption is available independent of the bilateral agreement.* Local law may provide exemptions to certain types of organizations, *e.g.*, not-for-profit NGOs. If USAID assistance is being provided through a for-profit contractor or local recipient, the exemption may not be available. If an exemption or reimbursement is available to the contractor or recipient, the tax payment is typically not allowable.

d. **Determine Whether the Contractor/Recipient Has Employed Best Efforts to Invoke the Exemption.** The tax may nonetheless be allowable if the organization can demonstrate that it has a made best efforts to invoke the exemption or receive a reimbursement, even if unsuccessful. Determining whether a contractor or recipient has used best efforts will be fact-specific and requires the informed and considered judgment of the CO/AO. Depending on the context, the contractor or recipient may need to demonstrate that it followed: (i) the tax exemption or reimbursement procedures that the host government agreed upon with USAID; or (ii) host-country law in attempting to invoke the exemption or right to reimbursement, or otherwise challenge the tax assessment. For example, COs/AOs might allow the tax payment in the following situations:

- The organization attempts to invoke the tax exemption by presenting a tax exemption letter, card, or other document to a vendor, but the vendor refuses to accept the document and insists upon payment of the tax. There is no process for obtaining a refund and there were no alternate sources.

- The organization makes reasonable and timely attempts to obtain reimbursement of a host-country tax based on the bilateral agreement, but the host country fails to provide the reimbursement for reasons beyond the control of the organization. There are no reasonably available legal processes for challenging the tax or the host-country government's failure to issue reimbursement.

- The organization has been assessed a tax from which it should be exempt under the applicable bilateral agreement and properly challenges the assessment under the laws of the host country (*e.g.*, through a court action), but a final decision is not forthcoming. In the meantime, the host government's tax authority has threatened to take further action against the organization if the tax is not promptly paid.[7]

- USAID involvement is needed to obtain an exemption or reimbursement of taxes for a USAID-funded project. In some cases, the bilateral agreement requires that the U.S. Government submit and receive all reimbursement requests directly, effectively preventing a contractor or recipient from obtaining a direct refund. The contractor or recipient follows the proper mission-specific steps and promptly submits required documents to USAID.

[7] Note that as to contracts, if these efforts are insufficient, FAR 31.205-41(a)(2) authorizes the CO to provide instructions to contractors to challenge a tax assessment.

e. Determine Whether Other Circumstances Warrant Allowing the Tax. This guidance is not exhaustive and there are numerous other scenarios in which a tax payment could be allowed, despite the potential availability of an exemption or reimbursement. Those situations include the following:

- *Indirect Reimbursement Authorized.* In some countries, the USAID Mission submits and eventually receives reimbursement from the host country, but then retains the reimbursement rather than forwarding it to the contractor or recipient who paid the tax. In this case, USAID should provide the tax reimbursement documentation to the contractor or recipient in order to credit the award for tax and other applicable costs.

- *Administrative Burden.* In some instances, taxes may be allowable if the CO/AO determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing USAID. *See* FAR 31.205-41(b)(3); 22 C.F.R. § 200.470(b)(1)(i). For example, in countries where the procedures for seeking an exemption or reimbursement are cumbersome or not widely understood, a USAID Mission may make a determination that taxes paid below a certain monetary threshold are allowable.

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Table 1, Cost Principle Excerpts

Title 48: Federal Acquisition Regulations System PART 31—Contract Cost Principles and Procedures Subpart 31.2 - Contracts with Commercial Organizations 31.205-41 -- Taxes.	Title 2: Grants and Agreements PART 200—Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards Subpart E—Cost Principles §200.470 Taxes (including Value Added Tax).
(b) The following types of costs are not allowable: (3) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Government, except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Government.	(b) For nonprofit organizations and Institutes of Higher Education (IHEs): (1) In general, taxes which the non-Federal entity is required to pay and which are paid or accrued in accordance with GAAP, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for: (i) Taxes from which exemptions are available to the non-Federal entity directly or which are available to the non-Federal entity based on an exemption afforded the Federal Government and, in the latter case, when the Federal awarding agency makes available the necessary exemption certificates