

Contractor Withholding Requirement Request for Assistance

Good Afternoon: NASACT is requesting your assistance in identifying the impact of a new contractor withholding requirement that is to be imposed on federal, state and local governments. As you may already be aware, the “Tax Increase Prevention and Reconciliation Act” recently signed into law includes a provision which raises approximately 7 billion in revenue by requiring governments to withhold 3% on certain payments to persons providing property or services. The provision, while proposed in the Treasury Blue Book, was not a part of either the House or Senate version of the reconciliation bill and was added with little knowledge during conference negotiations.

In addition to being a \$7 billion dollar revenue raiser, the provision is the Administration’s attempt to undermine misreporting by certain government vendors not currently subject to withholding. The Blue Book reasons that information reporting and back-up withholding have proven to improve compliance in other areas and should be imposed on government vendors to address this “particularly egregious component of the tax gap.”

Effective January 1, 2011, the provision would require governments (and political subdivisions exceeding aggregate payment of \$100 million or more for goods and services) to withhold 3% regardless if the government making the payment is the recipient of the goods or services. Furthermore, the law provides that several types of payment are exempt from the provision including payments made through public assistance or welfare programs where eligibility is needs or income based. Payment for health or other services based on age would not be exempt. Some of the other exemptions include: payments of interest, payments for real property, payments to tax-exempt entities or foreign governments, intra-governmental payments, payments based on a classified or confidential contract and to a government employee not otherwise excludable with respect to their service as an employee.

Initial inquiries reveal that the provision could cause administrative burdens for some states (particularly those with older systems) by imposing record keeping for “*reconciliation between the vendors billed and what we have paid to them, and to the IRS on their behalf.*” Payments made via purchase card may also prove problematic in obtaining proper information for record keeping. Additionally, the imposition of such a requirement may put governments at a competitive disadvantage as the withholding requirement is not imposed for private sector payment of goods and services and government vendors may inflate their bids to compensate for the withholding.

Senator Larry Craig (R-Idaho) recently introduced legislation (S. 2821) to repeal the provision. In a statement regarding the legislation, Senator Craig exclaims “that proponents of the withholding provision that describe it as closing a tax loophole are expressing nonsense. Reporting requirements are already in place for

government contractors. All this does is buck the IRS's collection responsibilities to the taxpayers. Not only does the federal government spend taxpayers' dollars, but this provision would make taxpayers bear the burden and cost of collecting them too. The way it functions, this language will take money out of the hands of individuals and businesses for up to 15 months, instead of letting them keep and use it until taxes are due. The government will end up holding this money, interest-free, instead of letting it circulate through the economy. On all counts, this is bad policy. My bill will put it right."

The Congressional Budget Office reports that new withholding requirement exceeds the annual threshold established in the Unfunded Mandates Reform Act thereby constituting an unfunded mandate on state and local governments.

NASACT is requesting your assistance in identifying the full impact of the new provision. Please provide any comments you may have to cchebinou@nasact.org. Should you have any questions, I can be reached at 202-624-5451 or via email at the address above.

A copy of provision and excerpts from the conference report are attached.