

Mandatory Withholding on Government Contracts

NSBA supports enforcement of current laws rather than requiring random withholding

NSBA has been working to repeal a provision—scheduled to go into effect on Jan. 1, 2012—that mandates federal, state and local governments withhold three percent from payments for goods and services. This flawed tax withholding requirement affects all government contracts as well as any new payment to any person for a good or service provided to a government entity. Federal agencies also are expected to abide by the withholding rule, which also applies to state and localities that spend more than \$100 million a year.

On May 17, 2006 President George W. Bush signed into law *H.R. 4297 (the Tax Increase Prevention and Reconciliation Act of 2005)*, which included this unfair withholding burden on government contractors. Efforts were made in the years following to delay or altogether repeal this problematic provision and continue today in the 112th Congress.

This requirement hurts honest taxpaying businesses while attempting to find tax delinquents by essentially forcing companies to provide the federal government with an interest-free loan. It is based on revenue from government payments with no relationship to a company's taxable income, and the three-percent withholding significantly affects businesses' cash flow needed for day-to-day operations.

This proposal was the first tax gap proposal to be enacted, signaling what lengths the Internal Revenue Service (IRS) will go to in order to close the tax gap. Government contractors were cited as the "bad apples" by the Government Accountability Office (GAO), which documented widespread abuse over a three-year period by certain contractors who did not pay their tax debts.

The Joint Committee on Taxation (JCT) estimates that the three percent mandate would only generate \$7 billion over five years, with only about \$1.1 billion being additional revenue and the rest being the "float" from advanced payment to the government. However, it now appears that the cost of implementing the law will greatly exceed the revenues that were anticipated from the mandate. A study released by the Department of Defense (DoD) estimates the implementation cost of the law will cost their department alone \$17 billion over the first five years.

In the *American Recovery and Reinvestment Act (ARRA)*, Congress delayed for one year the implementation of this mandate in recognition of the exorbitant expenditures that will be necessary to implement accounting systems and hire new compliance employees.

Merely delaying the effective date is not a solution because there still is no equitable, practical, or cost-effective way to implement this requirement. Efforts are already underway in the 112th Congress to repeal this egregious provision. Several lawmakers in the Senate have introduced legislation, the *Withholding Tax Relief Act of 2011 (S. 89 and S. 164)* to repeal the withholding provision. Similarly, in the House, Reps. Wally Herger (R-Calif.) and Earl Blumenauer (D-Ore.) introduced *H.R. 674* to fully repeal this tax law.

NSBA remains committed to Congressional efforts to fully repeal this onerous government requirement. While NSBA supports the goal of closing the tax gap, these efforts should target the people who are actually failing to pay their taxes, rather than imposing higher costs to compliant businesses.