

Mandatory Withholding on Government Contracts

NSBA supports better enforcement of current laws rather than requiring a withholding

NSBA has been working to repeal a provision that mandates federal, state and local governments withhold three-percent from payments for goods and services. This new tax withholding requirement affects all government contracts as well as any new payment to any person for a good or product provided to a government entity. Federal agencies also are expected to abide by the withholding rule, which applies to state and localities that spend more than \$100 million a year. The provision is not expected to take effect until Jan. 1, 2011.

On May 17, President George W. Bush signed into law *H.R. 4297 (the Tax Increase Prevention and Reconciliation Act of 2005)*. The tax cut package contained the Section 511 provision that places this unfair burden on government contractors. Legislation was introduced in both the House (*H.R. 6242*) and the Senate (*S. 2821*) in the 109th Congress that would repeal the withholding requirements. Legislation to fully repeal the three-percent withholding requirement has yet to be reintroduced in the 110th Congress.

This new 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 flows needed for day-to-day operations.

According to the Senate Finance Committee, the withholding requirements will ensure greater compliance and are expected to raise \$7 billion for the federal government over the next 10 years. The issue here focuses on the tap gap and ways to curb the amount of money the Treasury loses every tax year. For tax year 2001, the Internal Revenue Service estimates a tax gap—the difference between what taxpayers should have paid and what they actually paid—of \$290 billion. Government contractors have been cited as the “bad apples” by the Government Accountability Office, which has documented widespread abuse over a three-year period by those contractors who have not paid their tax debts.

Concerns have grown that acceleration of the effective date for the three-percent withholding requirement or an increase in the percentage rate could continue to come up again as revenue offset for another type of government expense. This was attempted by Sens. Ron Wyden (D-Ore.) and Gordon Smith (D-Ore.) during consideration of the *Tax Relief and Health Care Act of 2006*.

Both senators considered filing an amendment to fully fund a one-year extension of the *Secure Rural Schools and Community Self Determination Act of 2000*, which expired in September 2006. In order to fund the extension without a new tax or increasing existing taxes, the senators proposed changing the effective date of the withholding requirement to Dec. 31, 2006. Fortunately, the amendment was withdrawn.

As part of the Government Withholding Relief Coalition, NSBA remains committed to Congressional efforts to fully repeal this onerous government requirement. NSBA is concerned an acceleration of the effective date could be viewed by Congress as a revenue raiser to offset costs in a tight budget environment. NSBA is working to ensure Congress does not accelerate the implementation date or increase the percentage rate as this will have an increasingly-negative affect on small businesses.