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Repeal the 3% Withholding Tax

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Background: The 3% withholding tax was enacted as Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. Originally set to take effect in 2011, it requires government agencies at all levels (federal, state, and local) to withhold 3 percent of their payments to businesses for goods and services. This amount is held as a down payment of the business's federal income tax liability. The 2009 "stimulus" law delayed the effective date of the tax until 2012, and earlier this year, the IRS issued regulations that provide for an additional one-year delay, to 2013.

In February, Congressman Wally Herger (R-CA) introduced H.R. 674, a bill to permanently repeal the 3% withholding tax.

What We Know:

- **What the Bill Will Do:** Amend the Internal Revenue Code to repeal the 3% withholding tax on purchases of goods and services by government agencies.
- **Withholding Tax Hurts Small Businesses:** Many businesses that contract with government agencies operate on profit margins of less than 3 percent, so the withholding tax will create serious cash-flow problems for them.
- **Withholding Tax Costs Taxpayers:** The Department of Defense estimated that implementing the withholding tax will cost \$17 billion for DoD alone – more than the total revenue the tax is projected to raise. Cash-strapped state and local governments will also face substantial implementation costs.

The Case for Repeal: If the 3% withholding tax takes effect as scheduled on January 1, 2013, it will harm small businesses and raise costs for governments. While the withholding tax was intended to improve tax compliance, its actual effect is to punish the vast majority of law-abiding vendors and contractors. Instead of a new tax, Congress should support initiatives to improve information sharing among agencies to prevent tax-delinquent businesses from obtaining contracts.

Conclusion: Repealing the 3% withholding tax will help small businesses maintain profitability and create jobs. It will also eliminate an unfunded mandate for state and local governments.

MEMBER ACTION ITEM: All RSC Members are encouraged to cosponsor H.R. 674 to repeal the 3% withholding tax. Please contact Jay Sulzmann at 5-3076 or Jay.Sulzmann@mail.house.gov to support this legislation.

