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2111 WILSON BOULEVARD, SUITE 400  
ARLINGTON, VA 22201-3061  
(703) 522-1820 • (703) 522-1885 FAX  
WWW.NDIA.ORG

September 14, 2010

The Honorable Nancy Pelosi  
Speaker of the House  
United States House of Representatives  
H-232  
Washington, DC 20515

Dear Madam Speaker:

The National Defense Industrial Association (NDIA) with 1753 corporate members, and over 85,000 individual members strongly urge you to include a two-year delay of the 3% tax withholding law prior to the end of the 111<sup>th</sup> Congress. NDIA continues to vigorously advocate for repeal of this overly burdensome, costly and inefficient law; however, a delay is urgently needed now to prevent any additional wasteful expenditure of funds and manpower by all levels of government and companies in order to prepare for the looming implementation deadline of January 2012.

The 3% withholding law, which was enacted in Section 511 of the *Tax Increase Prevention and Reconciliation Act of 2005* (P.L. 109-222) as section 3402(t) of the Internal Revenue Code, mandates that federal, state, and local governments withhold 3% of nearly all of their contract payments, Medicare payments, farm payments, and certain grants. Compliance with this law will impose significant, unnecessary financial burdens on both the public and private sectors. NDIA stands ready to work with Congress and the Administration to improve tax compliance for companies and other entities receiving federal dollars while also repealing the onerous 3% withholding tax.

NDIA is especially concerned with the very real impact on our nation's small businesses, particularly when much of the hoped for economic recovery is placed squarely on their shoulders. Prime contractors may well pass much of the 3% expense down to their smaller subcontractors. Additionally, the small businesses who contract directly with the government will even more acutely feel the 3% withholding cut into their already narrow profit margins, especially as they will be forced to increase debt levels and lines of credit to ensure their ability to maintain operations. Businesses of all sizes do not need additional limits on capital while the economy begins to recover.

The 3% withholding is a flat percentage of revenues from government payments, bears no relationship to companies' taxable incomes, and will restrict cash flow needed for day-to-day operations and investments. In addition, the administrative and capital investment costs to businesses and governments will be substantial and the withholding mandate will be exceedingly complicated to implement.

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The National Defense Authorization Act for Fiscal 2007 (Public Law 109-364) required Department of Defense (DoD) to estimate the cost to implement the 3% withholding. DoD reported to Congress on April 14, 2008 that it would cost DoD **\$17 billion over five years** to implement. At a time when the Administration, the DoD and the defense industry are all struggling to achieve efficiencies and reductions in overhead costs, the un-programmed cost to administer the withholding comes at a critical time when providing goods and services to the warfighter is, and should be, our number one priority.

There have been numerous legislative and regulatory measures put in place since the enactment of the 3% withholding law that have focused on increasing tax compliance and enhancing transparency for companies receiving government payments. All these initiatives taken together obviate any rationale or need for retaining the withholding mandate and will be far more cost-effective for the government. Attached is a summary of these new additional initiatives that enhance transparency and increase tax compliance. These measures and proposals directly address the legitimate concerns about tax-delinquent government contractors and other entities receiving federal payments. NDIA continues to believe these are a much better approach than the costly, broad brush mandate of the 3% withholding law.

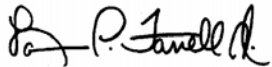
All these measures taken together pursue the laudable goal of tax compliance in a way that puts the burden of the law and regulation more on the tax avoiders, and provides a positive inducement to law-abiding firms and the public agencies with which they do business. The overwhelmingly large percentage of government contractors who abide by current laws should not and must not be made to shoulder the burden of the few who do not. The regulatory vigilance mandated by these additional measures will keep tax avoiders out of the public contracting market in the first place, rather than shifting the compliance burden to law-abiding firms and the federal, state and local governments.

While the withholding requirement is not scheduled to go into effect until January 1, 2012, it is already proving costly, and such costs will increase exponentially as the implementation deadline moves closer. Businesses and governmental entities are starting to expend resources now in preparation for implementation due to major system and process changes needed for withholding, reporting, and reconciling the millions of affected payments annually. These changes have to be made well in advance of 2012.

Madam Speaker, NDIA strongly believes approving a two-year implementation delay until 2014 before the end of this year is urgently needed to prevent governments and companies from incurring these costs. The unintended consequences of the 3% withholding will likely drive many of our nation's struggling business from the government marketplace and could drive them out of business all together.

Along with an immediate two-year delay, we ask that Congress require an independent entity to assess the costs of the 3% withholding regime for federal, state, and local governments and the companies that provide goods and services to them.

Sincerely and Respectfully,



Lawrence P. Farrell, Jr.  
Lt. General, USAF (Ret)  
President and CEO

CY TO: Representative John Boehner, Minority Leader, U S House of Representatives  
Representative Sander M. Levin, Chairman, House Committee on Ways and Means  
Representative Dave Camp , Ranking Member, House Committee on Ways and Means  
Senator Harry Reid. Majority Leader, U.S. Senate  
Senator Mitch McConnell, Minority leader, U.S. Senate  
Senator Max Baucus, Chairman, Senate Committee on Finance  
Senator Charles E. Grassley, Ranking Member, Senate Committee on Finance

Attachment: Summary of initiatives that enhance transparency and increase tax compliance.

## Legislative and Regulatory Developments Since the Enactment of Section 511 That More Efficiently Address Tax Gap Concerns

Since the enactment of Section 511 of the *Tax Increase Prevention and Reconciliation Act of 2005* on May 17, 2006, there have been a number of legislative and regulatory developments that together address issues with tax compliance and transparency by companies receiving government payments:

- **Federal Awardee Performance and Integrity Information System (FAPIIS):** The final rule implementing this database for contracts was issued on March 23, 2010, and the proposed guidance implementing it for grants was issued on March 10, 2010. These rules were promulgated to implement Section 872 of P.L. 110-417, which was passed on October 14, 2008, and created a federal legal compliance database requiring Contracting Officers and grant officials to check for prospective contractor legal compliance (tax compliance among the records checked) before the award of a federal prime contract.
- **Tax Compliance Certifications on All Contracts:** On May 22, 2008, a final Federal Acquisition Regulation took effect requiring contractors to certify they are current on their federal taxes. The tax certification language requires government contractors to certify that the offeror and its principals have no delinquent federal taxes and explicitly makes tax delinquency grounds for suspension and debarment.
- **Administration Memo on Tax Compliance:** On January 20, 2010, the Administration released a memo requiring the Internal Revenue Service to review the certifications of non-delinquency in taxes that are required on all federal contracts (mentioned above). The directive also requires the Office of Management and Budget, working with other agencies, to develop recommendations to prevent companies with serious tax delinquencies from receiving contracts and to make contractor certifications more easily available. Self certifications are a powerful screening incentive for tax-compliant firms, as false certifications bring about False Claims Act penalties and contract suspension and debarments. The burden and weight of the regulation fall on the tax malfeasant, not the tax-compliant firms. The President's directive to tighten enforcement of the government contractor tax non-delinquency certification reinforces key concerns about certifications to the government.
- **New 1099 Reporting:** Section 9006 of the Patient Protection and Affordable Care Act (P.L. 111-148) that became law on March 23, 2010, requires businesses and federal, state and local governments that pay any amount greater than \$600 during the year to corporate and non-corporate providers of property and services to provide a 1099 information report to each provider and to the IRS. Information reporting was already

required on payments for services to non-corporate providers. The increased use of 1099 reporting has been identified as a measure for increasing tax compliance.

- **USA Spending.gov:** The Federal Funding Accountability and Transparency Act of 2006 (P.L. 109-282) requires the creation of a single, searchable website, accessible by the public that includes information on all federal contract and grant awards. This increases transparency for the public of agency prime contract and subcontract spending so awards will be subject to increased disclosures to the public.
- **Central Contractor Registration (CCR) Database:** The CCR system has been rolled out to all federal contracting agencies since 2004, and a debt flag was added in 2009.
- **Treasury Offset Program Expanded:** The Treasury offset program has been expanded (through an interim rule on January 11, 2007, and final rule on June 10, 2009) to include State Debts.

*Prospective:*

- **Improvements Stemming from Administration Memo:** As directed by the January 20, 2010 memo mentioned above, OMB, working with other agencies, will develop recommendations to prevent companies with serious tax delinquencies from receiving contracts and to make contractor certifications more easily available.
- **Provision in House Bill to Require Disclosure of Tax Debts:** Section 403 of H.R. 5013, which passed the House on April 28, 2010 (likely to be included in the FY 2011 National Defense Authorization Act), requires potential federal contractors and grantees to submit certifications as to whether they have a seriously delinquent tax debt and to authorize the Secretary of the Treasury to verify the certifications. The concepts in Section 403 are in alignment with those industry has supported in the past in order to demonstrate the need to repeal the 3% withholding tax.
- **Treasury Green Book Proposal:** The Department of the Treasury's Green Book released with the President's FY 2011 Budget includes a proposal (page 101) to allow information reporting on federal non-wage government payments. This proposal would enhance transparency and therefore increase tax compliance without imposing an enormous burden on the government sector.