

Senators aim to stave off 3 percent tax withholding for contractors

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Senators from both sides of the aisle are attempting to preempt a controversial requirement that the government withhold 3 percent of its total payments to most contractors for tax purposes.

Last week, Sens. Scott Brown, R-Mass.; Olympia Snowe, R-Maine; and Amy Klobuchar, D-Minn., unveiled a bill to repeal a mandate that federal, state and local governments with expenditures of more than \$100 million withhold 3 percent of payments for products and services worth more than \$10,000, including nonconfidential or classified contracts, grants to for-profit companies, and farm and Medicare payments. The requirement is scheduled to take effect on Jan. 1, 2012.

Sens. David Vitter, R-La.; Richard Burr, R-N.C.; James Inhofe, R-Okla.; Johnny Isakson, R-Ga.; and Roger Wicker, R-Miss., have introduced similar legislation.

"Many of our Massachusetts companies are hit with a 3 percent withholding tax for simply doing government contract work," Brown told the North Suburban Chamber of Commerce in Woburn, Mass., on Monday. "I am introducing legislation to repeal that tax, which will give these businesses more capital to invest and create jobs."

If the requirement is not repealed, then companies will lose funds needed to operate day-to-day activities and could be forced to finance the additional amount, or pass along added costs to the government, Brown's office said.

The provision was included in the 2005 Tax Increase Prevention and Reconciliation Act in an effort to ensure that individuals and companies with outstanding tax debts do not receive new payments from the federal government. Critics suggest that numerous regulatory and legislative measures have been passed in recent years increasing the tax compliance of companies that receive government payments.

The withholding process would closely mirror the withholding system on individual salaries and wages. The government would set aside 3 percent of the gross payments and the information and funds would then be transmitted to the Internal Revenue Service. At the end of the year, the amount withheld would be credited toward taxes owed.

On Friday, the Government Withholding Relief Coalition wrote to Rep. Darrell Issa, R-Calif., the new chairman of the House Oversight and Government Reform Committee, urging him to focus on the law and its impact.

"The provision is already proving costly and will increase exponentially as the implementation deadline moves closer," the group of 116 business associations argued. "If this tax is not repealed, it will cost companies and governments at all levels substantial amounts of money. These exorbitant expenditures will be at the expense of hiring new employees, expanding businesses, and providing government services at a time that neither the public nor private sector can absorb such unnecessary costs."

The coalition noted the law makes no attempt to specifically target delinquent tax cheats and punishes all companies and individuals, including those with a clean tax record. Implementing the provision also

will impose significant administrative costs and reporting requirements on governments and companies, the group said.

In an April 2008 memorandum to the House and Senate Armed Services committees, James Finley, then-deputy undersecretary of Defense for acquisition and technology, wrote that implementing the provision would cost the Pentagon more than \$17 billion in the first five years -- a price tag that included escalating costs that contractors charge. The provision could also "limit the number of companies willing to enter into the government market, thereby reducing competition and access to new technologies," Finley wrote.

The law initially was set to go into effect on Jan. 1, 2011, but a provision in the 2009 Recovery Act delayed the implementation date by one year. The IRS issued a proposed rule implementing the provision in December 2008 and is scheduled to release its final rule soon.