

**HJR**

**41**

Member

*Standing Committees:*  
Judiciary  
State Affairs

*House Special Committee:*  
Ways & Means

*Finance Subcommittees:*  
Administration  
Courts

# Alaska State Legislature

## House of Representatives



**Representative Max F. Gruenberg, Jr.**

**House District 20**

**Anchorage (Mountain View, Russian Jack, East Anchorage)  
House Minority Assistant Floor Leader**

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### **SPONSOR STATEMENT FOR HJR41**

#### **BY: REPRESENTATIVE MAX F. GRUENBERG, JR.**

This resolution urges Congress to repeal sec. 511 of P.L. 109-222, the Tax Increase Prevention and Reconciliation Act of 2005.

This provision was added by a congressional conference committee without benefit of any public hearings in either the House or Senate.

If this provision remains law, starting in 2011 it will require states and local governments that spend more than \$100 million each year on goods and services to withhold three percent of the price of those goods and services and transmit those funds to the IRS to apply to any taxes that may be owed by vendors.

Section 511 was enacted to save approximately \$7 million in federal taxes between 2011 and 2015. However, the effect of that law would increase the burden and costs to state and local governments by making them uncompensated and involuntary federal tax collectors, because no federal funding is provided.

Government officials have stated that this provision will be extremely difficult and expensive to implement, requiring major programming changes to their financial and accounting systems and the hiring of additional staff. The state's accounting system is 23 years old, and the state has had difficulty avoiding mandatory backup withholding, which would be costly and time-consuming. This provision would make mandatory withholding even more difficult to avoid.

Local businesses would be discouraged from bidding on state and local governmental contracts, because of the three percent withholding. This would dampen competitive bidding and probably raise prices to the state and local government.

**CS FOR HOUSE JOINT RESOLUTION NO. 41(RLS)  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
TWENTY-FIFTH LEGISLATURE - SECOND SESSION**

**BY THE HOUSE RULES COMMITTEE**

**Offered:  
Referred:**

**Sponsor(s): HOUSE RULES COMMITTEE**

**A RESOLUTION**

1 **Urging the United States Congress to repeal sec. 511 of P.L. 109-222 (Tax Increase**  
2 **Prevention and Reconciliation Act of 2005).**

3 **BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 **WHEREAS** sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation  
5 Act of 2005) will require states, cities, counties, and boroughs that spend more than  
6 \$100,000,000 each year on goods and services after December 31, 2010, to withhold three  
7 percent of their payments to nearly all vendors and contractors for federal income purposes  
8 and to report nonwage payments; and

9 **WHEREAS** sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation  
10 Act of 2005) was added by a congressional conference committee without benefit of any  
11 public hearings in either the United States House of Representatives or the United States  
12 Senate; and

13 **WHEREAS**, although sec. 511 of P.L. 109-222 (Tax Increase Prevention and  
14 Reconciliation Act of 2005) was inserted into the legislation to save approximately  
15 \$7,000,000,000 in federal taxes between 2011 and 2015, the effect of the provision is to  
16 increase the burden and costs to state and local governments by making these governments

1 uncompensated and involuntary federal tax collectors because no federal funding is provided  
2 to cover the costs of implementing sec. 511 of P.L. 109-222 (Tax Increase Prevention and  
3 Reconciliation Act of 2005); and

4 **WHEREAS** sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation  
5 Act of 2005) creates another unfunded federal mandate that will add a cost to state and local  
6 governments that exceeds the threshold of P.L. 104-04 (Unfunded Mandates Reform Act of  
7 1995), and sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation Act of  
8 2005) will therefore short circuit the public process required by P.L. 104-04 (Unfunded  
9 Mandates Reform Act of 1995) and thus violate that Act; and

10 **WHEREAS** the Department of Administration, the University of Alaska, the  
11 Municipality of Anchorage, the Fairbanks North Star Borough, and the Anchorage School  
12 District, all governmental entities in Alaska that are affected by sec. 511 of P.L. 109-222 (Tax  
13 Increase Prevention and Reconciliation Act of 2005), have expressed serious concerns about it  
14 and have urged its repeal; and

15 **WHEREAS** local governmental officials have stated that sec. 511 of P.L. 109-222  
16 (Tax Increase Prevention and Reconciliation Act of 2005) will be extremely difficult and  
17 expensive to implement, requiring major programming changes to financial and accounting  
18 systems and the hiring of additional staff; and

19 **WHEREAS**, because of the three percent withholding requirement, local businesses  
20 will be discouraged from bidding on state and local governmental contracts for products and  
21 services, thereby dampening competitive bidding and driving up the prices to offset the three  
22 percent withholding and that this, in turn, is likely to increase the cost of procurement by state  
23 and local governments; and

24 **WHEREAS** sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation  
25 Act of 2005) will pose significant difficulties for the State of Alaska in its efforts to procure  
26 goods and services for the state, because

27 (1) the state accounting system is 23 years old and cannot accommodate  
28 mandatory backup withholding;

29 (2) it would take about a year to make the necessary systemic changes and  
30 require substantial additional record keeping to reconcile the amounts paid to vendors and  
31 those amounts reported and remitted to the Internal Revenue Service;

1 (3) obtaining exemptions to sec. 511 of P.L. 109-222 (Tax Increase Prevention  
2 and Reconciliation Act of 2005) would be difficult and costly; and

3 (4) vendors might inflate their bids to compensate for the tax withheld,  
4 resulting in higher prices to the state; and

5 **WHEREAS** the state government accounting system does not currently have the  
6 capability to withhold vendor payments, and the state need only report payments for services  
7 over \$600 a year to each unincorporated vendor; sec. 511 of P.L. 109-222 (Tax Increase  
8 Prevention and Reconciliation Act of 2005) will increase the accounting burden on the state  
9 by

10 (1) requiring most but not all payments, no matter how small, to be reported  
11 (an extremely expensive and burdensome mandate);

12 (2) requiring payments to all corporations to be reported, significantly  
13 increasing the number of vendors for which information reports would have to be submitted  
14 to the Internal Revenue Service;

15 (3) requiring withholding on credit card purchases, a process of unknown  
16 complexity; and

17 (4) exempting certain types of payment that will likely require manual  
18 intervention, which would drive up the cost of compliance with sec. 511 of P.L. 109-222 (Tax  
19 Increase Prevention and Reconciliation Act of 2005) even further; and

20 **WHEREAS** government agencies will have to obtain employee identification  
21 numbers or social security numbers for numerous individual vendors to allow reporting to the  
22 Internal Revenue Service, thereby invading those citizens' rights of privacy and exposing  
23 them to the dangers of identity theft; and

24 **WHEREAS** complying with sec. 511 of P.L. 109-222 (Tax Increase Prevention and  
25 Reconciliation Act of 2005) will have serious adverse effects on the procurement practices of  
26 larger local governments in Alaska; for example, the Municipality of Anchorage, the state's  
27 largest city, with a population of about 261,446, which is 42 percent of the state's total  
28 population, will incur costs of approximately \$250,000 a year to reprogram municipal  
29 computers and financial systems, plus an estimated \$100,000 to \$200,000 a year of additional  
30 costs for ongoing operating expenses; the Municipality of Anchorage's financial computer  
31 system is not set up for this procedure and will require extensive modifications at a significant

1 cost, including the hiring of at least one full-time municipal employee; the use of  
2 procurement-cards by the Municipality of Anchorage may have to be discontinued and the use  
3 of checks, which are slower and more costly, may be reinstated; the Municipality of  
4 Anchorage's online purchasing system will have to be modified and likely will no longer be  
5 cost-effective; and

6 **WHEREAS** the additional costs of complying with sec. 511 of P.L. 109-222 (Tax  
7 Increase Prevention and Reconciliation Act of 2005) will place the State of Alaska and Alaska  
8 local governments at a competitive disadvantage in the procurement of goods and services;  
9 and

10 **WHEREAS**, as a result of these burdens and difficulties, the state and affected local  
11 governments believe that sec. 511 of P.L. 109-222 (Tax Increase Prevention and  
12 Reconciliation Act of 2005) will not accomplish its stated goal of closing the budget gap; and

13 **WHEREAS** these concerns were previously expressed by the state to the United  
14 States Congress through the National Association of State Auditors, Comptrollers and  
15 Treasurers; and

16 **WHEREAS** S. 777 and H.R. 1023 have been introduced in the 110th United States  
17 Congress to repeal sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation Act  
18 of 2005);

19 **BE IT RESOLVED** that the Alaska State Legislature urges the United States  
20 Congress to repeal sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation Act  
21 of 2005).

22 **COPIES** of this resolution shall be sent to the Honorable Ted Stevens and the  
23 Honorable Lisa Murkowski, U.S. Senators, and the Honorable Don Young, U.S.  
24 Representative, members of the Alaska delegation in Congress; and all other members of the  
25 110th United States Congress.

# FISCAL NOTE

**STATE OF ALASKA**  
**2008 LEGISLATIVE SESSION**

Fiscal Note Number: 1  
 Bill Version: HJR 41  
 ( ) Publish Date: 4/8/2008

Identifier (file name): \_\_\_\_\_ Dept. Affected: ADM  
 Title Urging the United States Congress to repeal sec. 511 of P.L. 109-RDU  
 \_\_\_\_\_ Component \_\_\_\_\_  
 Sponsor House Rules \_\_\_\_\_ Component Number \_\_\_\_\_  
 Requester \_\_\_\_\_

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information					
		FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
<b>OPERATING EXPENDITURES</b>							
Personal Services							
Travel							
Contractual							
Supplies							
Equipment							
Land & Structures							
Grants & Claims							
Miscellaneous							
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>							
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<b>CHANGE IN REVENUES ( )</b>							
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2008) cost: 0.0

**POSITIONS**

Full-time							
Part-time							
Temporary							

**ANALYSIS:** (Attach a separate page if necessary)

Prepared by: Rachelle Fenderson, House Rules Committee Aide  
 Division: House Rules Committee  
 Approved by: Representative John Coghill, Chairman  
House Rules Committee

Phone 465-3719  
 Date/Time 4/8/08 4:30 PM  
 Date 4/8/2008

**Bill History/Action for 25th Legislature**

**BILL:** HJR 41

**SHORT TITLE:** REPEAL OF SEC. 511 OF P.L. 109-222

**BILL VERSION:**

**CURRENT STATUS:** (H) RLS

**STATUS DATE:** 04/07/08

**SPONSOR(s):** RULES

**HEARING:** (H) RLS Apr 08 4:00 PM CAPITOL 120 Moved CS/HJR 41(RLS) Out of Committee

**TITLE:** Urging the United States Congress to repeal sec. 511 of P.L. 109-222 (Tax Increase Prevention and Reconciliation Act of 2005)

Bill Number:

Jrn-Date	Jrn-Page	Action
04/07/08	2699	(H) READ THE FIRST TIME - REFERRALS
04/07/08	2699	(H) RLS
04/07/08	2699	(H) REFERRED TO RULES

Similar Subject Match or Exact Subject Match

INTERGOVERNMENTAL RELATIONS

MUNICIPALITIES

PUBLIC FINANCE

TAXATION

Bill Number:

[Return to Basis Main Menu \(25th Legislature\)](#)



# STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

ANNETTE KREITZER, COMMISSIONER

SARAH PALIN, GOVERNOR

P.O. BOX 110200  
JUNEAU, ALASKA 99811-0200

PHONE: (907) 465-2200  
FAX: (907) 465-2135

April XX, 2008

The Honorable  
United States Senate  
Washington, DC 20510

Dear Senator XXXX,

As Commissioner of the Department of Administration for the State of Alaska, I am writing to express the State of Alaska's strong support for repealing Section 511 of the Tax Increase Prevention and Reconciliation Act (TIPRA) of 2006, which requires governments to withhold 3% on payments made for most goods and services.

If enacted, Section 511 of TIPRA will impose an enormous burden on state and local governments, most of which do not have the systems or capacity to implement this onerous and costly withholding provision. Additionally, it will place governments at a competitive disadvantage as private sector businesses do not have to comply with this requirement.

As a state finance official, I have grave concerns regarding the impact of this poorly vetted provision on the current accounting and procurement systems in my state. Preliminary research indicates that not only will implementation costs be significant and include both administrative and financial commitments, but also that governments will face an increase in the costs of goods and services as vendors will simply pass along the 3% cost when bidding for government business.

I oppose Sec. 511 as an unfunded mandate and disagree with this new policy of shifting the burden of federal tax collection to state and local governments. I strongly urge you to support repealing this provision.

Sincerely,

Annette Kreitzer

## Repeal Three Percent Withholding Tax on County Purchases

**Issue:** Section 511 of the Tax Increase Prevention and Reconciliation Act (P.L. 109-222) requires counties that spend more than \$100 million annually on purchases to withhold and remit to the IRS three percent of most payments for products and services.

**NACo policy:** NACo supports repeal of Section 511 of P.L. 109-222. This is among NACo's key federal legislative priorities for 2007.

**Action needed:** County officials should urge their members of Congress to cosponsor H.R. 1023 (Rep. Kendrick Meek, D-Fla., and Rep. Wally Herger, R-Calif.). This bill would repeal Section 511 of P.L. 109-222.

**Background:** H.R. 4297, the "Tax Increase Prevention and Reconciliation Act of 2006", was signed into law as P.L. 109-222 on May 17, 2006. Section 511 will require many counties beginning in 2011 to withhold federal taxes on nearly every payment for a service or product – from plumbing services to paper clips - with no minimum transaction and regardless of whether the payment is made by check or credit card. The requirement does not apply to the private sector. It is estimated to raise \$6 billion for the federal treasury through a first-year accounting gimmick and slightly more than \$200 million per year thereafter.

According to the Congressional Budget Office, this is an intergovernmental mandate with costs above the threshold of the Unfunded Mandates Reform Act. It will be very expensive for counties to implement and will require programming changes to financial and accounting systems and the hiring of additional staff. It will also likely discourage contractors from bidding on government contracts and increase the costs of procurement. Many of its requirements are unworkable as written and will require the Treasury Department to issue 'administrability rules'. This mandate is particularly egregious because it was inserted into the final version of an omnibus tax bill that had already passed both the House and Senate and was never subject to a formal vote, hearings or consultation with any state and local government officials or their national organizations.

On February 13, 2007, Representatives Kendrick Meek (D-Fla.) and Wally Herger (R-Calif.) introduced H.R.1023 to repeal this unfunded mandate on county government. NACo is asking members of Congress to cosponsor this legislation. It is important to demonstrate broad support for this legislation because it faces an uphill climb due to its \$7 billion price tag.

For further information, contact: Alysoun McLaughlin 202/942-4254 or [amclaughlin@naco.org](mailto:amclaughlin@naco.org).



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*Advocacy: the voice of small business in government*

August 31, 2006

VIA FACSIMILE and EMAIL

The Honorable Larry E. Craig  
United States Senate  
520 Hart Senate Office Building  
Washington, DC 20510

RE: S. 2821 *Withholding Tax Relief Act of 2006*

Dear Senator Craig:

I am writing to express support for your legislation, S. 2821, the *Withholding Tax Relief Act of 2006* (S. 2821). This legislation will repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) (TIPRA). The withholding provision in TIPRA is a broad new requirement mandating that federal, state and local governments withhold 3 percent from payments made for goods and services. Small business groups have expressed a high level of interest in S. 2821 to the Office of Advocacy (Advocacy). Advocacy takes its direction from small business groups which is why we are writing this letter of support.

Congress established Advocacy under Pub. L. 94-305 to represent the views of small businesses before Federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed in this letter do not necessarily reflect the views of the SBA or the Administration.

Section 511 of TIPRA presents significant challenges for small entities and state and local governments. American small businesses operate in an environment which challenges them to be competitive and remain profitable. The withholding provision will impede the cash-flow of small entities, presenting another obstacle to their success. Section 511 of TIPRA amounts to a tax penalty on government contractors without a clear path for reimbursement. The amount of the penalty is variable; for instance if a contract generates a small profit or no profit the additional withholding presents serious cash management challenges. Additionally, the

withholding provision inhibits the efficient use of capital because it will limit funds that can be used to reinvest in the business.

In fiscal year 2005, the Federal government spent over \$300 billion purchasing goods and services from businesses. Purchases from small businesses represented almost \$80 billion. Two-thirds of the Federal government procurement falls under the Department of Defense (DOD). The Government Accountability Office (GAO) issued a report entitled "DOD Payments to Small Businesses" (GAO-006-358, May 2006). GAO concluded that disruptions in cash flow caused by contracting with DOD can significantly affect the day-to-day operations of small businesses. Adding a 3 percent tax withholding requirement will only exacerbate the cash flow issues already experienced by small entities seeking to do business with the government.

In addition to the burdens that may be imposed on small businesses by the withholding provision, section 511 of TIPRA may have unintended administrative costs on all levels of government required to collect the tax. The withholding requirement at a minimum will require changes to be made to the accounting methods and software used by governmental jurisdictions. That may be why the Congressional Budget Office described the withholding provision as an unfunded intergovernmental mandate.

Repealing section 511 of TIPRA will help small businesses maintain their ability to provide goods and services to governments at all levels. Thank you for your efforts on behalf of small businesses. Advocacy looks forward to working with you and Congress to repeal this provision.

Sincerely,

/s/ \_\_\_\_\_  
Thomas M. Sullivan  
Chief Counsel for Advocacy

# Government Withholding Relief Coalition

Home

Join the Coalition

Members of Coalition

Text of Withholding Provision -  
Section 511 of Tax Reconciliation  
Act of 2005 (P.L. 109-222)

House Small Business  
Committee Hearing -  
Statements for the Record

Letters to Governors

News Articles

## Government Withholding Relief Coalition (GWRC)

The Government Withholding Relief Coalition (GWRC) was formed to repeal a sweeping new requirement mandating that federal, state, and local governments withhold 3 percent from payments for goods and services. This unprecedented withholding mandate will affect all government contracts as well as other payments, such as Medicare and grants, starting in 2011. Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) enacted this requirement into law.

### Coalition Letters

- [July 17, 2007 - Letter to House Ways and Means Committee](#)
- [March 22, 2007 - Statement for the Record to House Small Business Committee](#)
- [March 12, 2007 - Letter to Senator Craig in support of S. 777](#)
- [March 8, 2007 - Letter to Treasury Department](#)
- [February 15, 2007 - Letter to Rep. Meek and Herger in support of H.R. 1023](#)
- [January 17, 2007 - Letter in opposition to use of 3% withholding as an offset](#)
- [October 16, 2006 - Letter to Representative Herger in support of H.R. 6242](#)
- [July 11, 2006 - Letter to Senator Craig in support of S. 2821](#)

### Department of Treasury Solicitation for Comments on Implementation: Due April 28

- [Treasury's Notice 2008-38](#)

### Resources

- [One-page summary of provision](#)
- [Talking Points](#)
- [Draft Letter to Congress for Businesses to Utilize](#)

### Material

- [June 12, 2007 - Senators Collins and Coleman Letter](#)
- [March 13, 2007 - Dear Colleague letter in support of S. 777 - Senator Craig](#)
- [February 22, 2007 - Dear Colleague letter in support of H.R. 1023 - Rep. Meek and Herger](#)
- [September 19, 2006 - Letter from Senator Craig to Senate colleagues in support of S. 2821](#)
- [August 31, 2006 - Letter to Senator Craig from SBA Office of Advocacy in support of S. 2821](#)
- [May 9, 2006 - CBO Letter with Annual Budgetary Effects](#)

### Bills to Repeal Provision

- [Senate - S. 2394 \(110th Congress\)](#)
- [Senate - S. 777 \(110th Congress\)](#)

- [House - H.R. 1023](#) (110th Congress)
- [Senate - S. 2821](#) (109th Congress)
- [House - H.R. 6242](#) (109th Congress)



# Municipality of Anchorage

P.O. Box 196650 • Anchorage, Alaska 99519-6650 • Telephone: (907) 343-4431 • Fax: (907) 343-4499 <http://www.muni.org>

Mayor Mark Begich

Office of the Mayor

April 3, 2008

The Honorable Max Gruenberg  
Alaska House of Representatives  
State Capitol, Room 110  
Juneau, AK 99811

Dear Representative Gruenberg:

I write to commend you for your sponsorship of a resolution urging repeal of a federal tax provision in the Tax Increase Prevention and Reconciliation Act of 2005, which is certain to have a detrimental effect on the Municipality of Anchorage and other government entities across our state. I also thank you for bringing this misdirected provision to our attention.

This provision would require cities and other government entities across the nation to withhold a 3 percent payment from nearly all vendors and contractors for federal income tax purposes, if it becomes effective in 2010 as currently intended. As your measure correctly points out, this could cause chaos to Anchorage's finance and computing systems, costing taxpayers thousands of dollars a year.

We support your call for repeal of this provision and again thank you for pursuing this important resolution in the current legislative session.

Sincerely,

Mark Begich  
Mayor

*Community, Security, Prosperity*



## *Issue Brief:* New Government Withholding Provision Could Involve Costs to States

National Association of State Budget Officers

October 3, 2006

444 N. Capitol Street, Suite 642 • Washington, DC 20001 • (202) 624-5382 (phone) • (202) 624-7745 (fax) • [www.nasbo.org](http://www.nasbo.org)

The government withholding provision under the *Tax Increase Prevention and Reconciliation Act of 2005* is set to go into effect on January 1, 2011 and will require state and local governments to withhold three percent of nearly all payments to contractors or vendors. The three percent is then remitted to the federal government for federal income tax purposes. The federal government projects that the withholding provision will generate \$1 billion between 2011 and 2015. The goal of the provision is to reduce the amount of underpayment of federal taxes by government vendors not currently subject to withholding. Numerous concerns regarding withholding have been raised by various state and local groups. These concerns include added costs involving administrative changes, that the withholding provision is an unfunded mandate, and a lack of clear regulations and guidelines.

### **BACKGROUND**

On May 17, 2006, the *Tax Increase Prevention and Reconciliation Act of 2005* was signed into law. Major elements of this law include extending the fifteen percent tax rate on capital gains and dividends, and preventing an increase in the number of taxpayers subject to the Alternative Minimum Tax. Another important component of the law that received far less publicity, but could impact state and local governments, requires governments to withhold three percent on certain payments to persons providing property or services. The provision will not go into effect until 2011.

### **Specifics of Withholding Provision**

The withholding provision extends the act of withholding to new areas. Under the withholding provision, all levels of government are required to withhold three percent on most payments for products and services. According to the summary provided by the Senate Finance Committee, the provision "requires withholding on certain payments to any person providing property or services made by the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the state." Governments would then be required to remit three percent of most payments to the federal government for federal income tax purposes. The withholding provision will go into effect on January 1, 2011.

Prior law states that employers are required to withhold income tax on wages paid to employees, including wages paid to employees of federal, state, and local government. This law has not previously included withholding payments to workers who are not classified as employees, such as independent contractors. Instead, independent contractors and other taxpayers who receive income that is not subject to withholding are required to make estimated tax payments.

There are some exemptions to the withholding provision. First, localities and other political subdivisions of states with less than \$100 million of annual expenditures for goods or services are exempt from the withholding requirement. Second, the provision exempts payments made through a federal, state, or local government public assistance or public welfare program for which eligibility is determined by a needs or income test. Finally, the provision exempts payments of interest, payments for real property, payments to tax-exempt entities or foreign governments, intergovernmental payments, payments based on a classified or confidential contract, and payments made to a government employee not otherwise excludable with respect to their service as an employee.

#### **Reasons for Withholding Provision**

The main stated justification for the withholding provision is to attempt to undermine the misreporting of taxes by certain government vendors not currently subject to withholding. It is one of a series of steps designed to help minimize the tax gap. According to the IRS, in 2001 taxpayers paid \$345 billion less than what they should have paid. This caused the Joint Committee on Taxation (JCT) to produce a report in 2005 entitled *Options to Improve Tax Compliance and Reform Tax Expenditures*. The first recommendation of the report was to impose withholding on certain payments made by government entities. The JCT contended that a lack of a withholding requirement on non-wage payments leads to substantial underpayment of taxes each year. Additionally, the JCT argued that requiring withholding on government entities for non-wage payments would improve taxpayer compliance, promote fairness, and reduce the tax gap. According to government estimates, the withholding provision will raise \$7 billion for the federal government between 2011 and 2015.

#### **ISSUES RAISED REGARDING WITHHOLDING PROVISION**

State and local groups have begun to raise numerous concerns about the withholding provision. The law is vague in many areas, and specific regulations have yet to be established. Further details regarding the implementation of the withholding provision will be determined by the Department of Treasury. Currently, many state and local government associations are monitoring developments regarding the withholding provision. In addition to NASBO, these associations include the National Governors Association (NGA), the National Association of Counties (NACo), the National Association of State Auditors, Comptrollers, and Treasurers (NASACT), the National Conference of State Legislatures (NCSL), the National League of Cities (NLC), the United States Conference of Mayors, the Federation of Tax Administrators (FTA), the National Association of State Retirement Administrators (NASRA), and the Government Finance Officers Association (GFOA). Some of the primary issues that have been raised concern:

- **Unfunded mandate** – As reported by the Congressional Budget Office (CBO), the Joint Committee on Taxation (JCT) has determined that the cost of the withholding provision exceeds the threshold specified in the *Unfunded Mandates Reform Act*.
- **Costs to states** – state and local governments will receive no funding from the federal government in exchange for providing this service. Additionally, states will likely have to make programming changes to financial and accounting systems, purchase new software, register vendors, possibly hire additional staff, and keep massive new data files and paper reports.

- Applies only to public sector – state and local governments would be required to withhold three percent on payments, but private companies would not. This could place state and local governments at a disadvantage.
- Lack of consultation – neither the original House nor Senate version of the *Tax Increase and Prevention Act of 2005* contained the withholding requirement. Instead, the provision was added in the conference committee. This prevented state and local governments from expressing their views on the measure.
- Perceived need for withholding arose regarding federal contracts – one of the main justifications for the withholding provision is that the Government Accountability Office (GAO) issued a report showing that 3,800 General Services Administration (GSA) federal contractors had tax debts. Instead of creating a withholding provision that applies to all levels of government, Congress could have passed a law that only applies to federal contractors.
- Inflating bids – vendors and contractors could increase their bids by three percent in order to compensate for withholding. This would cause state and local governments to spend additional funds.
- Purchasing cards – the provision also requires withholding on purchases made by purchasing cards. Many questions have been raised regarding how withholding can be accomplished using purchasing cards.
- Many unanswered questions – in addition to the other issues, many additional unanswered questions remain regarding withholding, including how to report withheld amounts to the IRS or payees, how payments must be sent, and who is exempt and who is not.

### CURRENT STATUS OF WITHHOLDING PROVISION

Shortly after the *Tax Increase Prevention and Reconciliation Act of 2005* was signed into law this past May, Senator Larry Craig (R-Idaho) introduced legislation calling for the repeal of the withholding provision. Sen. Craig stated that, "Proponents of the withholding provision describe it as closing a loophole. That is nonsense. Reporting requirements are already in place for government contractors. All this does is buck the IRS's collection responsibilities to the taxpayers." In addition to Sen. Craig's legislation, Congressman Wally Herger (R-California) has also introduced legislation calling for repeal.

Furthermore, the National Association of Counties (NACo) has called for the repeal of the withholding requirement on the grounds that it is an unfunded mandate. Other state and local associations are continuing to monitor the issue and are hopeful that if the provision is not fully repealed, the Department of Treasury will take their concerns into consideration when establishing rules and guidelines.

*If you would like additional information regarding the government withholding provision, please contact Brian Sigritz at (202) 624-8439 ([bsigritz@nasbo.org](mailto:bsigritz@nasbo.org)) or Scott Pattison at (202) 624-8804 ([spattison@nasbo.org](mailto:spattison@nasbo.org)) in NASBO's Washington D.C. office.*

# United States Senate

WASHINGTON, DC 20510

June 12, 2007

The Honorable Max Baucus, Chairman  
The Honorable Charles E. Grassley, Ranking Member  
Committee on Finance  
United States Senate  
219 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Grassley:

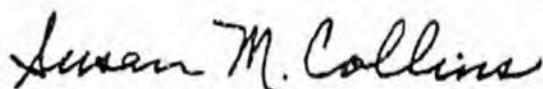
We write to you regarding the new 3% withholding tax on federal, state, and local government contracts for goods and services enacted as Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222). This 3% withholding tax is scheduled to go into effect in 2011.

While we understand and support your commitment to closing the tax gap, we do not believe that Section 511 is the appropriate means to achieve that goal. We are concerned that the 3% withholding provision is overbroad, and will unfairly penalize contractors that pay their taxes. Many of these contractors operate on very narrow profit margins – often 3% or less – and will be unable to comply with Section 511's withholding requirement without sacrificing the lion's share of their cash flow.

We are particularly concerned about the impact of the 3% withholding provision on small businesses in the construction industry. Contractors rely on their cash flow to finance investment and expansion, and as security for bonds they are required to hold in order to do business with the federal government. The 3% withholding requirement may so severely restrict cash flow that contractors will find it difficult or impossible to secure bond coverage, and as a result, many contractors will be driven out of the market. This, in turn, will lead to higher prices for the goods and services they supply to the federal government.

We are seeking a workable alternative to Section 511 that helps to address the problem of the tax gap without placing an undue burden on honest contractors. We would welcome the opportunity to work with you towards that end.

Sincerely,



SUSAN M. COLLINS  
United States Senator



NORM COLEMAN  
United States Senator