

Statement for the Record
Before the
Subcommittee on Contracting and Workforce
Committee on Small Business
U.S. House of Representatives

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Defer No More: The Need to Repeal the 3% Withholding Provision

Submitted on Behalf of the

Government Finance Officers Association (GFOA)
International City/County Management Association (ICMA)
International Municipal Lawyers Association (IMLA)
International Public Management Association for Human Resources (IPMA-HR)
National Council on Teacher Retirement (NCTR)
National League of Cities (NLC)
National Association of Counties (NACo)
National Association of State Chief Information Officers (NASCIO)
National Association of State Auditors, Comptrollers and Treasurers (NASACT)
National Association of State Budget Officers (NASBO)
National Association of State Procurement Officials (NASPO)
National Association of State Retirement Administrators (NASRA)
National Conference of State Social Security Administrators (NCSSSA)
United States Conference of Mayors (USCM)

Chairman Mulvaney, Ranking Member Chu and Members of the Sub-Committee:

Thank you for holding this very important hearing to discuss a provision that is of the utmost concern to state and local governments. Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) requires federal, state, and local governments to withhold three percent on payments made for most goods and services. This provision not only places a severe administrative and economic burden on state and local governments, but unfairly punishes tax compliant contractors. H.R. 674 would repeal this troubling provision. We hope that this hearing will alert Congress to the importance of passing H.R. 674 immediately.

The groups offering this statement represent state and local governments nationwide that are very concerned with the impact of the three percent withholding provision, on not only state and local governments, but on the small businesses across the country that assist governments by delivering vital public services. Government contractors not only build roads and schools, but they provide numerous critical services to our most underprivileged and needy citizens. The most powerful engine of opportunity and economic growth in this country is small business. We are glad to see that this subcommittee is exploring the effects of Section 511 on these entities.

As you are aware, Section 511 was added to the Tax Increase Prevention and Reconciliation Act during conference negotiations, without input from the entities responsible for implementing this burdensome requirement. While we agree with the law's underlying goal of ensuring that taxpayers pay all of their applicable taxes, placing the burden of enforcing compliance with federal tax laws on state and local governments is an unfunded mandate. This mandate places undue responsibilities on state and local governments and also punishes contractors that do business with those entities. Small businesses across the country will surely be affected, as they will not be able to compete for government contracts due to the increased costs of doing business with the government. The same holds true for subcontractors, who will likely be hit financially as prime contractors are compelled to pass costs associated with the three percent withholding requirement down to their subcontractors.

We know that you will not be surprised by the statement that state and local governments are facing some of the most trying economic times in history, and although economic indicators tell us that we are starting to emerge from the difficult financial times, focusing scarce resources on implementing such a questionable provision simply does not make sense. Now more than ever resources are desperately needed to carry out critical government programs, and government contractors and their employees are an important component in delivering those services.

We recognize that the important focus of this hearing is on the provision's impact on small business. However, we would like to also call your attention to some of the unique challenges state and local governments will face in implementing Section 511.

As you know, the sophistication of the state and local systems needed to capture and report the data required by Section 511 varies greatly between governments. Most entities that we have polled do not currently have the resources, capacity, or staff to undertake the required withholding and remittance processes. Making modifications or purchasing new systems to accommodate this burdensome requirement does not top of the list of state and local priorities during such difficult economic times. Without significant funding, our ability to comply with the three percent withholding requirement, even with the extended implementation date, is questionable.

We estimate that under the new law, the current levels of reporting we undertake will be increased by two to three-fold. Issues inherent in collecting vendor information, undertaking the matching of taxpayer identification numbers (TINs), and the sheer estimated increase in errors and the subsequent error correction processes are daunting. In addition to the increased administrative costs to state and local governments to handle the increased reporting, governments will also face increased costs for goods and services as vendors will simply pass the three percent along.

We reiterate that that the costs associated with this new law bear no tangible benefit for state and local governments. While we agree with the notion of assuring that taxpayers pay all of their applicable taxes, this unfunded mandate places an undue burden on government entities and is a

powerful disincentive for contractors that compete for government business. Building roads and schools, delivering services, and retaining and hiring employees are far better uses for the resources that will be required should this withholding provision stand.

There appears to be a belief that because state and local governments undertake backup withholding, the new requirement will be easy to accommodate. A poll we have conducted on this exact issue has shown that automated backup withholding processes are not the norm. The notion that governments can simply convert the backup withholding process to Section 3402(t) withholding is a misnomer. In many state and local governments across the country, backup withholding is undertaken manually, as it occurs infrequently.

Furthermore, the precedent of requiring lower levels of government to collect what is essentially a federal tax on contractors is concerning for a number of reasons. The federal government should not conscript state and local governments to act as its agents.

State and local governments are not the only entities that will face implementation issues. Businesses will also face enormous administrative and financial challenges as a result of Section 511 at a time when their resources should be focused on creating jobs and encouraging growth. In many cases, the three percent withheld will exceed a government contractor's profit margin and dramatically affect the contractor's cash flow. This, in turn, will reduce the amount of money available for payroll, new business investment, and everyday expenses.

Enhanced transparency and tax compliance should always be a priority; however, we truly believe that there are numerous other more effective and more efficient ways to tackle the issue of vendor tax compliance. Since the passage of Section 511 in 2006, numerous legislative and regulatory provisions have been put into place to focus on increasing tax compliance. Such provisions include:

- The Federal Awardee Performance and Integrity Information System (FAPIIS): 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:** A federal acquisition rule that requires tax certification language requiring contractors to certify they are current on their federal taxes.
- **Administration Memo on Tax Compliance:** President Obama released a memo requiring the Internal Revenue Service to review the certifications of non-delinquency in taxes that are required on all federal contracts.
- **USASpending.gov:** A single, searchable website, accessible by the public, which includes information on all federal contract and grant awards. This increases transparency for the public of agency prime contract and subcontract spending subjecting awards 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.
- **Expansion of the Treasury Offset Program Expanded:** The Treasury Offset Program has been expanded to include state debts.

More information on these initiatives is available on the Government Withholding Relief Coalition's website at www.WithholdingRelief.com.

We believe that the financial and economic costs of implementing Section 511 far outweigh the estimated revenue that the provision is expected to raise and that addressing vendor tax compliance can be achieved without punishing compliant contractors and small businesses. In the interests of state and local governments and the contractors and small businesses that provide goods and services to citizens across the country, we strongly encourage repeal of the three percent withholding provision.

We thank you for recognizing the problematic nature of Section 511 and for holding this important hearing. We hope that this hearing brings important focus to a provision that needs to be repealed immediately. Our members have already expended scarce resources in planning for the implementation deadline. The main goal of state and local governments is and should be

focusing limited resources on the very important task of delivering vital public services, and we hope that Congress will address repeal as quickly as possible.

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