DRAFT (1/9/2006) – Government Withholding Relief Coalition Talking Points

OPPOSE THE 3% WITHHOLDING ON ALL GOVERNMENT PAYMENTS

Repeal Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222).

Costs Will Be Greater Than the Increased Revenue to the Government. The estimated $215 million per year of increased revenue due to tax compliance will be less (we believe far less) than the additional costs to administer the program by the government, the increase in bid rates to governments due to added costs, etc.

Private Sector Administrative Costs. The administrative costs to companies, as well as to governments, are substantial. Companies' internal systems are not set up to track these payments, which will become extraordinarily complex when involved in complex business ventures with multiple partners or subsidiaries. For companies receiving thousands of government payments per year at multiple locations, this will be very administratively time consuming and costly.

$6 billion of the estimated $7 billion in "increased revenue" from 2011 to 2015 comes from an accounting gimmick. Actual savings are only around $215 million per year. The provision is aimed at collecting underreported tax revenues and increased tax compliance. While an admirable goal, the bulk of the $7 billion revenue score is due to the acceleration of tax receipts during the transition year and not an actual revenue increase from improved tax compliance. The provision generates only $215 million in 2012 and increases slightly in each of the following years.

Commercial items. Governments have been moving toward obtaining commercial products and services at commercial prices (products/prices that are the same in the private sector marketplace). This provision severely alters this system that has shown great progress in reducing prices to the government. This will put government at a severe, competitive disadvantage relative to private sector firms buying the same products and services (GSA Schedules prices will have to all be altered).

Credit Card Purchases. Large amounts of government purchases are made with government-issued credit cards. There is no realistic way for the government to withhold 3% on payments in this situation where the credit card company is essentially the go-between.

Profit at end of contract life, withholding throughout. With many industries, particularly construction and shipbuilding, profits are at the end of the life of a multi-year contract. In these situations, the contractor will have little or no tax liability in the early years of the contract despite having 3% withheld throughout the life of the contract.

Government prime contractors subcontract significant percentages of the overall contract value. Companies of all sizes, but particularly small businesses, obtain large value government contracts and then subcontract significant portions of it. 3% of the total contract value would, in these cases, be well over the actual tax liability.

> Contract Value=$100 :: 3%=$3
> Subcontract 70% (that is not abnormal)
> $30 left for prime contractor
> If the profit margin on this is 10%, $3 is the total profit on the contract
> In this case, 100% of the profit would be withheld

Costs will be passed through to government. Companies will be forced to pass some of the 3% withholding costs through to the government; therefore, bids to governments will be higher and governments will be forced to pay more.

Costs will be passed down to subcontractors. Some companies may also be forced to pass some of the withholding amount down to their subcontractors who in turn will pass it onto their subcontractors. This hurts the supply chain, particularly small businesses down the supply chain.

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Companies forced to increase debt level or line of credit. Many contractors will have to take on higher levels of debt in order to ensure regular cash flows necessary for operations. Companies will be forced to finance the extra amounts being withheld.

Companies who receive a higher percentage of their revenue from government payments will be less competitive. Companies with a high percentage of government business will be at a competitive disadvantage relative to companies with a lower percentage of their revenue coming from government payments. More of their revenue stream will be tied up in withheld payments, leaving less free cash for operating expenses.

Existing laws are sufficient. Existing laws allocate significant enforcement authority to the government to force companies to pay their requisite tax liabilities. The government should better enforce current laws rather than requiring a withholding on tax-compliant companies.

Puts a heavy burden on entrepreneurial and start-up organizations. The withholding will be particularly painful for entrepreneurial and start-up companies that are commonly operating in the red and operating on financing and therefore have no profit or tax liability. The withholding requirement will deprive them of needed capital and force them to wait many months before withheld amounts are refunded.

Incorrect payments will be more difficult and costly to reconcile. Governments, similar to any business, inevitably make incorrect and late payments. While the company and government are working on reconciling the differences and correcting the mistake, taxes (or quarterly estimated withholding) will come due. The company will bear the costs of reconciling the government's errors.

Internal federal government issues: Where does the 3% come from? Treasury sends money to agencies that in turn make the payments to contractors. With this provision in effect, would Treasury withhold 3% on all payments to agencies or would the agencies refund the Treasury Department the 3%? There could be a bureaucratic fight over who will get the money and when.

An unfunded mandate on state and local governments. Federal tax compliance enforcement is the function of the IRS, not the state and local governments. This program is an unfair burden on lower levels of government. The cost to administer this program by altering accounting systems will be substantial and the Congressional Budget Office has stated it is an unfunded mandate.

Unconstitutional. The provision, as it relates to state and local governments, may be unconstitutional and will likely be challenged in court on those grounds. Congress isn't allowed to impose affirmative obligations on lower levels of government and the federal government only has jurisdiction that crosses state lines (commerce clause).

More county and city governments will be affected than one may think. Local governments with less than $100 million in expenditures are exempt from withholding requirement, but still many smaller county and city governments will be affected. Local governments with hospitals, universities, and schools could easily breach the $100 million mark. This will particularly be problematic for localities that break the threshold in some years due to a large capital project.

Medicare Payments. Medicare payments to hospitals and individual physicians will be affected by the 3% withholding as well. This will cause serious cash flow problems for hospitals. The Center for Medicaid and Medicare Services (CMS) will have to significantly alter their systems to implement the provision.

Farm Commodity Payments. Payments to farmers under a government commodity support program (Loan Deficiency Payments) are also subject to the withholding. The government has already set the value of these payments and an arbitrary 3% should not be withheld, especially because LDP's to farmers are highest in years that farmers are most financially strapped due to poor yields. Withholding on these is counterproductive to the program.

Grants withheld as well. Grants to for-profit companies (regardless if they are state or federal) will have 3% withheld. Grants by their definition are allocated to an entity for a specific purpose (i.e. research) and it makes no sense to withhold any percentage of them for tax purposes.