



### **THREE PERCENT WITHHOLDING REQUIREMENT ON GOVERNMENT PAYMENTS**

- Section 511 of the Tax Reconciliation Act for 2006 (P.L. 109-222) mandated that beginning in 2011, Federal, state, and local governments withhold 3 percent from payments for goods and services. This “tax” withholding requirement is applicable to all Government payments for products and services made by Federal, state, and local governments (local governments with expenditures of \$100 million or more).
- This requirement will have a significant affect on companies currently doing business with the Government and clearly will discourage commercial companies from entering the Government market. Over the last several decades, the Government has saved billions of dollars utilizing commercial products and services. It is a proven cost effective and successful strategy.
- The provision also has a substantial effect on cash flow for companies, particularly small businesses, which operate on tight margins. Companies will be forced to finance the withheld amount, and thus will be forced to allocate some of the increased costs into their bid rates on contracts, increasing overall costs to the Government. There will also be considerable costs to implement and administer the withholding program for the contracting community, as well as for Government (DOD recently released a report that it would cost them \$17 billion over 5 years in increased administrative and contract costs). Financial systems are not set up to track withholds on each payment and the transition to new systems will be expensive and complex.
- This new withholding focuses solely on company revenues with absolutely no relationship to tax liability. For some prime contracts, the 3 percent withheld may be more than the profit on the contract and, therefore, far more than the requisite tax liability on the contract. Also, for some procurements, the profit is at the end of the multiyear contract; however, the withholding will be from the beginning, further worsening a company’s cash flow situation.
- This provision also has a disproportionate effect on companies that have a higher percentage of their revenue coming from Government contracts relative to a competitor. The company doing more Government business will have more of their revenue stream withheld and therefore will be at a competitive disadvantage compared to a company bidding on the same contract with less Government business, causing an imbalance to the level playing field. This will have the effect of preventing the Government from receiving the best possible prices from its vendors.
- This withholding requirement has a broad negative impact on the Government’s ability to acquire goods and services at the best possible price by discouraging new and existing suppliers, inequitably affecting small businesses, and creating a competitive disadvantage as commercial suppliers do more business with the Government, while providing a questionable, if any, long-term benefit.