



February 26, 2009

CC:PA:LPD: PR [REG-158747-06]  
Room 5205  
Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

RE: Withholding Under Internal Revenue Code Section 3402(t)

Dear Sirs:

On behalf of the National Association of State Procurement Officials (NASPO), which represents the chief procurement officers of the fifty states and the District of Columbia, I am writing in response to the Department of the Treasury and Internal Revenue Service request for comments regarding IRC Sec. 3402(t) – Withholding on Payments by Governments. Your notice particularly asked for comments regarding how to implement this section.

### **Overall Reaction**

The implementation of this Section of the Tax Increase Prevention and Reconciliation Act of 2005 will cause a huge and undue administrative burden on states. In this challenging economic climate, states do not have the capability to address and develop new procedures and tools to support this provision. Impacts to vendors may bring cancelled contracts, potential service lapses, and will almost certainly result in higher prices for government entities.

### **P-Card and Credit Card Payments**

The direction given in the proposed regulations regarding p-cards is unclear – understanding that the state is ultimately responsible for the withholding, who actually collects the tax, and how? If that falls to the state, this is another potentially burdensome activity.

For example, the regulations state “...when a government entity or its payment administrator uses a credit card or payment card to pay a person for providing property or services, payment occurs at the point of sale when the government credit card or payment card is tendered and not when the government entity pays the credit card company.” This reads to mean that every time a credit card is used for a purchase over \$10,000, 3% is subtracted from the amount that would ordinarily be due. However, will the government owe the credit card company 3% less or will the credit card company actually reimburse the vendor the amount minus the 3%? How is this collection actually intended to work? (p. 11)

Pricing is also a concern. For those vendors with very minimal mark-ups, p-card and credit card service charges already impact their small profit margins and the 3% withholding may actually present an immediate loss on the purchase. Vendors may not be able to maintain current contracts, and would have to bid at least 3% higher prices on new contracts to balance the charge.

### **Material Modifications to Existing Contracts**

Who is responsible for determining what a “material” modification is? Are states to use the IRS definition? And if so, what is that definition?

If the company holding the contract at the time of the modification refuses to accept the addition of a 3% withholding clause absent financial offset in terms of an increase in contract price or other concessions, and the contracting entity cannot or will not allow the contractor to increase the contract price, then the government entity may find itself with a lapse of a critical contract and an emergency situation may result.

Certain contracts require a lengthy process leading up to contract award. Contracting entities will have to “predict” the date a contract might be awarded and thus “entered into” to ensure that contracts that take a long bidding and/or negotiation period contain necessary clauses. There may in fact be contracts out to bid now by states for complex technical systems that may be awarded after the effective date of the withholding requirement, but which do not include the 3% withholding terms. Can the resultant contractor be made subject to the requirement if the bid clauses did not include a withholding provision? State law and/or rules and regulations do not normally permit unilateral changes in contract clauses.

Also, some large volume strategically sourced contracts factor in long-term renewals. If the withholding is required to be added at the renewal, states would be significantly altering the terms of the original contract and therefore subject to re-negotiated prices—thus defeating the strategic sourcing effort and advantages.

**NASPO strongly recommends that any contract in existence within the allowed transition period, or for which bid documents have been issued prior to the finalization of the implementing regulations, be exempt through the life of the agreement (including renewals).**

### **Exemptions**

Payments to governmental entities are exempt, but what about public/private partnerships? Regarding single and sole source vendors, the regulations should include a provision that allows the contracting agency to waive the withholding requirements. Failure to include such a provision may place a state and its citizens in an emergency situation if a sole supplier of a critical good or service refuses to enter into a contract which contains the withholding provision.

Regarding payments in emergency or disaster situations, what is the timeframe for the Secretary to determine exception criteria and publication? (p.49). Additionally, if a state or local government establishes a contract with a third party for the purpose of providing disaster relief, does such contract and all payments due under it fall under this exemption or is the 3% withholding required?

Purchases made by a political subdivision of a State (or any instrumentality thereof) which makes less than \$100,000,000 of such payments annually are exempt from the withholding requirement per IRS Proposed Regulation Exemption (G). As state contracts are used by thousands of various-sized political subdivisions in the state, some of which may be fully exempt from the 3% withholding requirements per the cited section, the actual amount withheld from payments made pursuant to a state contract may be significantly less than 3% of the value of the contract. What type of record keeping will be required of states pursuant to the withholding provisions? Does the IRS expect the amount of withholding under a state contract to approximate 3% of the value of a contract? How will the IRS determine whether withholding is sufficient? Given exemption (G) in addition to the exemption for each use of a contract that totals less than \$10,000, it will be impossible for the state contracting office to determine in advance what percentage of its contract use would be exempt from withholding requirements. It is thus equally impossible for the contractor to predict the actual amount they will be paid under a contract for which they have subcontractor, employee and supplier commitments. Contractors (especially small businesses) could see significant and unpredictable interruptions in cash flow, even though they must pay their suppliers and employees in full and in a timely manner.

### **Disputes**

What entity will be responsible for addressing reporting disputes—the IRS or states? How would lingering disputes impact the contractor's ability to perform the contract? Would states have to suspend contractors because of an unresolved dispute or deny award to a vendor currently involved in a dispute?

In closing, NASPO and its members are strongly supporting legislation and Congressional members that are working to have this onerous section of the IRC repealed. We will continue to work with our partner organizations in this effort. Please feel free to contact NASPO if you would like additional input or clarification.

Sincerely,

A handwritten signature in black ink, appearing to be 'Vern Jones', written in a cursive style.

Vern Jones, NASPO President  
Chief Procurement Officer  
State of Alaska