

*Text Included in H.R. 4297*  
*Signed into law on May 17, 2006*

**SEC. 511. IMPOSITION OF WITHHOLDING ON CERTAIN PAYMENTS  
MADE BY GOVERNMENT ENTITIES.**

(a) In General- Section 3402 is amended by adding at the end the following new subsection:

`(t) Extension of Withholding to Certain Payments Made by Government Entities-

`(1) GENERAL RULE- The Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment.

`(2) PROPERTY AND SERVICES SUBJECT TO WITHHOLDING-

Paragraph (1) shall not apply to any payment--

`(A) except as provided in subparagraph (B), which is subject to withholding under any other provision of this chapter or chapter 3,

`(B) which is subject to withholding under section 3406 and from which amounts are being withheld under such section,

`(C) of interest,

`(D) for real property,

`(E) to any governmental entity subject to the requirements of paragraph (1), any tax-exempt entity, or any foreign government,

`(F) made pursuant to a classified or confidential contract described in section 6050M(e)(3),

`(G) made by a political subdivision of a State (or any instrumentality thereof) which makes less than \$100,000,000 of such payments annually,

`(H) which is in connection with a public assistance or public welfare program for which eligibility is determined by a needs or income test, and

`(I) to any government employee not otherwise excludable with respect to their services as an employee.

`(3) COORDINATION WITH OTHER SECTIONS- For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person for property or services which are subject to withholding shall be treated as if such payments were wages paid by an employer to an employee.'

(b) Effective Date- The amendment made by this section shall apply to payments made after December 31, 2010.

## *Statement of the Managers*

*Posted online at <http://finance.senate.gov/sitepages/leg/leg050906stat.pdf>*

### **TITLE VIII – OTHER REVENUE OFFSET PROVISIONS**

#### **Imposition of Withholding on Certain Payments Made by Government Entities (sec. 3402 of the Code)**

##### **Present Law**

##### **Withholding requirements**

Employers are required to withhold income tax on wages paid to employees, including wages and salaries of employees or elected officials of Federal, State, and local government units. Withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee.

Certain non-wage payments also are subject to mandatory or voluntary withholding. For example:

- Employers are required to withhold FICA and Railroad Retirement taxes from wages paid to their employees. Withholding rates are generally uniform.
- Payors of pensions are required to withhold from payments made to payees, unless the payee elects no withholding. Withholding at a rate of 20 percent is required in the case of an eligible rollover distribution that is not directly rolled over. Withholding from periodic payments is at variable rates, parallel to income tax withholding from wages, whereas withholding from nonperiodic payments is at a flat 10-percent rate.
- A variety of payments (such as interest and dividends) are subject to backup withholding if the payee has not provided a valid taxpayer identification number (TIN). Withholding is at a flat rate based on the fourth lowest rate of tax applicable to single taxpayers.
- Certain gambling proceeds are subject to withholding. Withholding is at a flat rate based on the third lowest rate of tax applicable to single taxpayers.
- Voluntary withholding applies to certain Federal payments, such as Social Security payments. Withholding is at rates specified by Treasury regulations.
- Voluntary withholding applies to unemployment compensation benefits. Withholding is at a flat 10-percent rate.
- Foreign taxpayers are generally subject to withholding on certain U.S.-source income which is not effectively connected with the conduct of a U.S. trade or business. Withholding is at a flat 30-percent rate (14-percent for certain items of income).

Many payments, including payments made by government entities, are not subject to withholding under present law. For example, no tax is generally withheld from payments made to workers who are not classified as employees (i.e., independent contractors).

##### **Information reporting**

Present law imposes numerous information reporting requirements that enable the

Internal Revenue Service (“IRS”) to verify the correctness of taxpayers’ returns. For example, every person engaged in a trade or business generally is required to file information returns for each calendar year for payments of \$600 or more made in the course of the payor’s trade or business. Special information reporting requirements exist for employers required to deduct and withhold tax from employees’ income. In addition, any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when the aggregate of payments is \$600 or more. Government entities are specifically required to make an information return, reporting certain payments to corporations as well as individuals.

Moreover, the head of every Federal executive agency that enters into certain contracts must file an information return reporting the contractor’s name, address, TIN, date of contract action, amount to be paid to the contractor, and any other information required by Forms 8596 (Information Return for Federal Contracts) and 8596A (Quarterly Transmittal of Information Returns for Federal Contracts).

#### **House Bill**

No provision.

#### **Senate Amendment**

No provision.

#### **Conference Agreement**

The conference agreement requires withholding on certain payments to persons providing property or services made by the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies). The withholding requirement applies regardless of whether the government entity making such payment is the recipient of the property or services. Political subdivisions of States (or any instrumentality thereof) with less than \$100 million of annual expenditures for property or services that would otherwise be subject to withholding under this provision are exempt from the withholding requirement.

The rate of withholding is three percent on all payments regardless of whether the payments are for property or services. Payments subject to withholding under the provision include any payment made in connection with a government voucher or certificate program which functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the withholding requirement. The provision imposes information reporting requirements on the payments that are subject to withholding under the provision.

The provision does not apply to any 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. For example, payments under government programs providing food vouchers or medical assistance to low-income individuals are not subject to withholding under the provision. However, payments under government programs to provide health care or other services that are not based on the needs or

income of the recipients are subject to withholding, including programs where eligibility is based on the age of the beneficiary.

The provision does not apply to payments of wages or to any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. The provision does not exclude payments that are potentially subject to backup withholding under section 3406. If, however, payments are actually being withheld under backup withholding, withholding under the provision does not apply.

The provision also does not apply to the following: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in section 6050M(e)(3)); and payments to government employees that are not otherwise excludable from the new withholding provision with respect to the employees' services as an employees.

Effective date.—The provision applies to payments made after December 31, 2010.

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#### **TITLE XI – UNFUNDED MANDATES**

The staff of the Joint Committee on Taxation has reviewed the tax provisions in the conference agreement for H.R. 4297, the “Tax Relief Extension Reconciliation Act of 2005” as agreed to by the conferees. This information is provided in accordance with the requirements of Public Law 104-04, the Unfunded Mandates Reform Act of 1995, which provides that if a conference agreement contains (1) a mandate that was not previously considered by either the House or the Senate, or (2) an increase in the direct cost of a previously considered mandate, then the committee of conference is to ensure, to the greatest extent practicable, that a mandates statement is prepared.

We have determined that the tax provisions of the conference agreement contain two unfunded private sector mandates that were not previously considered by either the House or the Senate: (1) repeal of FSC-ETI grandfather rule, and (2) amend section 911 housing exclusion. In addition, the provision relating to withholding on certain government payments imposes an intergovernmental mandate not previously considered by either the House or the Senate.

The costs required to comply with each Federal private sector mandate and Federal intergovernmental mandate generally are no greater than the aggregate estimated budget effects of the provision as indicated on the enclosed revenue table. Benefits from the provisions include improved administration of the tax laws and a more accurate measurement of income for Federal income tax purposes.

*Summary from Senate Finance Committee*

*Posted online at <http://finance.senate.gov/sitepages/leg/leg050906sum.pdf>*

**Withholding on Government Payments [Conference Provision]**

The National Taxpayer Advocate has concluded that the absence of a withholding mechanism on certain nonwage payments creates several problems, including contributing to the substantial tax gap and “harming compliant taxpayers because they pay their correct liability while others do not.” The proposal balances the goal of greater compliance with concerns regarding administrative burdens of imposing withholding. The conference agreement 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 foregoing (including multi-State agencies). Political subdivisions of States (or any instrumentality thereof) with less than \$100 million of annual expenditures for goods or services that would otherwise be subject to withholding under this provision are exempt from the withholding requirement. The rate of withholding is 3% on all payments (including all payments made in connection with a government voucher or certificate program) regardless of whether the payments are for property or services. The provision imposes information reporting requirements on the payments that are subject to withholding under the provision. The provision does not apply to any 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. For example, payments under government programs providing food vouchers or medical assistance to low-income individuals are not subject to withholding under the provision. In addition, the provision does not apply to payments of wages or to any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. The proposal does not exclude payments that are potentially subject to backup withholding under section 3406. If, however, payments are actually being withheld under backup withholding, withholding under the proposal does not apply. The proposal also does not apply to the following: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in section 6050M(e)(3)); and payments to government employees that are not otherwise excludable from the new withholding provision with respect to the employees’ services as an employees. The proposal applies to payments made after December 31, 2010, so the proposal has a negligible revenue effect over 5 years but is expected to raise \$6.977 billion over 10 years