

[Hanna: 3 Percent Withholding Hurts Small Businesses](#)

By Rep. Richard Hanna

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Q: What do President Barack Obama, Senate Majority Leader Harry Reid (D-Nev.) and House Majority Leader Eric Cantor (R-Va.) agree on?

A: There are major problems with the 3 percent withholding provision.

Countless Republicans, Democrats and small businesses have joined the call to repeal this onerous rule, which is really a tax.

My good friend and colleague Rep. Earl Blumenauer (D-Ore.) summed up the 3 percent tax as "grotesquely misguided." I agree.

Here's the background: This rule dates to 2005 and has been delayed from being implemented on a couple of occasions. It was meant to take effect on Dec. 31, 2011, but in May the IRS delayed it again until Dec. 31, 2013. Essentially, this provision would require local, state or federal governments to withhold 3 percent from all payments to any business that contracts goods and services.

Why? This rule was enacted to address the loss of revenue attributed to the "tax gap," meaning

the IRS believes businesses that contract with the government don't fully pay the tax that is owed. Many governments already require retention of sometimes 5 percent to 15 percent on contracts.

I am a small-business man. I've been in construction for more than 30 years in upstate New York, and I've done a lot of government work. I can testify that this tax will cost more than it saves. It will raise the total price of every job commissioned by the government. This comes at a time when profit margins are so compressed that businesses often earn little more than 3 percent.

This amounts to an unfunded loan to the government by contractors. It's a prime example of the law of unintended consequences by government at its worst. The 3 percent withholding provision is an attempt by government to control people through their money and not the rule of law. It's a fine without due process.

But this wouldn't affect only contractors.

Government agencies will need to upgrade accounting systems to withhold 3 percent of payments. The costs here may well outweigh any potential "gains" realized from this tax. The Department of Defense has estimated its implementation costs alone would be \$17 billion over the first five years.

Small businesses will be affected because this will significantly hinder day-to-day cash flow. The possibility that this could be enacted is causing some companies to avoid doing business with the government. More paperwork, accounting services and reporting requirements will be mandated. All this at a time when we should be trying to help small businesses, not burden them. There is also the inherent risk of not knowing whether or when the 3 percent would ever be received.

Public school systems and universities would also be affected by this tax. Costs would increase for any repairs or construction on these public campuses, and those costs will ultimately be passed on to students through tuition.

These are just some examples. This far-reaching tax will touch virtually all sectors in some way. Locally, taxpayers would be affected through police, fire and infrastructure repair budget hits.

Considering the major deterioration of our national infrastructure, the last thing we should be doing is increasing the cost to fix roads, bridges, sewers and other systems. The cost to rebuild and repair will only go up if the 3 percent withholding tax isn't repealed.

Above all else, this requirement will greatly lessen one great American value associated with contracts and bidding: competition. Contractors who deliver public services for local, state and federal governments could decide they simply can't afford to be government vendors. We should foster competition, not limit it.

Small businesses are key to our nation's vitality. In this struggling economy, the last thing lawmakers should be implementing is a tax on services provided that will ultimately cost more than it will bring in.

It boils down to this: Are we a nation of laws or are we a nation that penalizes a person before they've committed a crime? Do we believe it is fundamentally fair to treat those who are compliant with their taxes the same as those who evade them? I think not.

Let's permanently repeal the 3 percent withholding tax.

Rep. Richard Hanna (R-N.Y.) is a member of the Transportation and Infrastructure, Education and Workforce, and Small Business committees.

