

**Testimony by
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**House Committee on Small Business
Subcommittee on Contracting and Workforce
Defer No More: The Need to Repeal the 3% Withholding Provision
May 26, 2011, 10:00 A.M.
Room 2360, Rayburn House Office Building
Washington, DC**

Position:

Support full repeal of Section 511, 3 percent withholding on government contracts.

Comments:

Mr. Chairman and members of the Committee, I am honored to be here today. Thank you for the opportunity to testify on this very important matter.

I am here to urge you to repeal the federal 3% withholding provision, Section 511, which imposes a burdensome and costly mandate that will affect government contracts at all levels of government. Additionally, it will negatively affect businesses throughout the country. While the 3% withholding requirement was designed to increase tax compliance, it will unfairly penalize state and local governments and small businesses that run honest taxpaying companies. The IRS tax collection responsibility is being handed off to state and local governmental agencies and tax compliant businesses through this mandate.

The impact and unintended consequences of this withholding requirement on both governments and companies are detrimental. Excessive implementation costs come at a time when the public sector is trying to recover from economic havoc. Additionally, compliance with this requirement will prove financially oppressive to private industry and will cost jobs.

And, who will ultimately bear the cost of this new requirement? The taxpayer. The taxpayer will absorb the costs!

While I serve as the State Treasurer of South Carolina, I am also a small business owner. I would like to share with you how I see this law impacting both government and business.

Impact on Governments:

First, let's look at the negative effects on state and local governments.

The provision imposes administrative costs and information reporting requirements for implementation and maintenance of (1) the vendor tax withholding requirement, and (2) remission of the tax on behalf of the vendors to the Internal Revenue Service. In South Carolina, these responsibilities would be handled by the Comptroller General's Office.

In addition to these costs, the requirement presents an administrative nightmare. Modifications to accounting systems and other administrative processes will have to be resolved. Add up the manpower and dollar costs of the withholding provision for all of the local and state governments across the county and you will find the amount is astronomical.

Coupled with administrative costs, many believe that vendors may be inclined to increase their prices to governmental entities to compensate for this penalty tax in order to minimize their revenue losses. Some, if not all of the costs, may be passed on to governments through higher contractor bids. As a result, taxpayers will be forced to pay more.

The withholding law will negatively affect government budgets at a time when every dollar counts as we're all trying to recover from the great recession. Public budgets are already severely strained and budget woes continue to persist in many states and at all levels of government. Lower levels of government especially may not be able to sustain the burden of altering accounting systems and providing other services necessary to administer the program.

Federal tax compliance enforcement is the function of the IRS, not of state and local governments. This withholding provision would place an unfair burden on state and local governments during a time when they're already facing serious budget challenges.

Impact on S. C. and U. S. Businesses:

The withholding requirement is equally harmful financially to our country's businesses.

The 3% withholding requirement unjustifiably penalizes all tax compliant businesses. It forces businesses to provide the federal government with an interest-free loan by requiring advance payment of taxes that may not be due at the end of the year.

The provision will seriously affect businesses' cash flow, which has already been severely impacted by the economic downturn. The withholding is based on gross revenues from contract payments and has no relationship to businesses' taxable income. Businesses with tight profit margins will lose vital funds necessary for operations, and as a result, will be forced to pass the added costs on to their government customers. Cash flow may even be damaged to the point that some businesses withdraw from doing business with government altogether. Any business

expansion could be halted or deferred. Additional cash flow constraints could push some companies out of business completely.

The provision adds yet another layer of tax withholding and reporting requirements for both governmental entities and U. S. businesses.

Of course I am particularly concerned about what Section 511 will do to small businesses in South Carolina. Small business is essential to the financial well-being of South Carolina. In 2008, there were nearly 364,000 small businesses in my state. More than 81,000 of them were employers, accounting for nearly 50% of private-sector jobs. Small firms made up 97 percent of South Carolina's employers.

The withholding provision will gravely affect South Carolina small business cash flow. As companies lose essential funds needed for day-to-day operations, they will be forced to pass along the added cost of the Section 511 mandate to customers. Contractors operating on slim profit margins will pass along the cost to their subcontractors.

Small business is the engine that drives South Carolina's economy. The success of the small business sector is critical to my state's economic recovery. The withholding requirement will throw a ratchet into companies' operations by reducing the amount of money available for payroll, new business investment, and daily expenses. It will stifle small business expansion as well as new business upstarts.

The continued success of existing small business, along with new business enterprise, is key to South Carolina's ability to increase its gross state product, state personal income, and total employment. I am confident that the same is true for all of the other states. So, why hamper with economic performance by imposing this expensive and unwieldy withholding requirement? It's an unnecessary and costly interference with the vitality of small business.

The bottom line is that the 3% withholding mandate will be detrimental to the job market. South Carolina's unemployment rate in April was 9.8% (unadjusted), the ninth highest in the country. Marion County continued to have the highest jobless rate at 18.7%. It should be noted that these rates do not include those individuals who have stopped looking for jobs or those who have collected maximum benefits. Nor is it indicative of those who are underemployed. We simply cannot take a hit on employment in South Carolina.

There's a saying "an error we refuse to correct has many lives." I believe the negative consequences of this mandate will snowball. You have the opportunity to make it right by repealing it.

In summary, let's not block the progress of our state and local governments and our businesses by allowing this costly and burdensome legislation to take effect. The timing is especially critical as state and local governments and businesses throughout the country are struggling to recover from the worst economic slump in decades. At a time in our country's history when job creation is critically important to economic recovery, let's not allow this obstruction to impede progress. I ask for your help in repealing this withholding provision.

For the good of our state and local governments, private businesses, and individual taxpayers, I sincerely hope legislation repealing this withholding requirement becomes law and that it becomes law expeditiously before more money is spent preparing for its implementation. Time is of the essence as governments are entering into multi-year contracts now that may include increases due to the withholding provision.

I strongly urge the members of this Committee and the House to take action as quickly as possible to repeal Section 511.

In closing, I would like to commend Representative Herger for his work on H.R.674 which will repeal this onerous requirement, and Chairman Mulvaney for holding today's hearing on this issue.

Again, I appreciate the opportunity to testify before you today. I will be happy to answer any questions.