From the pages of ...

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Counties: Uncle Sam wants you to collect federal taxes

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The federal government is conscripting your county personnel into serving as federal tax collectors.

A new law may soon require your county to withhold 3 percent of nearly every payment to a vendor or contractor and send it to the federal government. According to Miriam Singer, director of procurement for Miami-Dade County, the new requirement — which applies to county purchases of everything from plumbing services to paper clips — amounts to "taxing local governments to subsidize the federal budget."

That is, of course, the point of this new requirement. The overall price tag on the tax bill signed into law in May was capped for procedural reasons at $70 billion. The House of Representatives insisted on including a $50 billion extension of the current tax rate on capital gains and dividends while the Senate insisted including a $30 billion "patch" on the Alternative Minimum Tax. To pay for including both in the final bill, conferees slipped a package of revenue raisers including this provision into the bill just prior to House and Senate passage, leaving no time for organized opposition.

Indeed, the Joint Committee on Taxation believes that counties, cities, states and federal procurement officers will collect more than $6 billion in taxes that government contractors and vendors would not otherwise have paid to the IRS in FY11.

Members of Congress have discovered that thousands of Pentagon contractors owe more than $3 billion in taxes to the federal government. Rather than simply enforcing the law against these contractors or imposing a new withholding requirement on contracts with the federal government, this new requirement will apply to states and any local government that spends more than $100 million per year on purchases of goods and services. Smaller cities and counties are exempt.

Counties will receive no compensation for providing this service to the federal government but will be required to spend millions to upgrade accounting software and hire staff to do the job of IRS auditors.

Christine Cohen, auditor-controller for Ventura County, Calif., said it is too soon to assess the dollar impact but, "I am sure that with the system programming changes, reporting requirements, staffing allocations and new deadlines, we would also be faced with price increases from vendors, adding to the cost of government projects."

Since the requirement only applies to the public sector — not private purchasers — Cohen is not alone in her concern that this new law will place counties at a competitive disadvantage in purchasing products and services. According to budget director Dawn Jindrich, Linn County, Iowa "already [has] trouble getting contractors to bid on some of our projects because of the additional requirements related to government contracts. This will make it even more difficult to do competitive bidding." Jindrich also questioned the logic of the requirement since many of the county's contractors are Subchapter S corporations that are already required to pay quarterly estimated taxes.

Tim Firestine, finance director for Montgomery County, Md. pointed out that counties already send a form 1099 to the IRS for payments in excess of $600 and questions why that is insufficient for the IRS to track down any vendor that does not pay their taxes.

Gary Malmgren, chief accountant for Contra Costa County, Calif. said a number of unanswered questions remain. For example, the law does not spell out how the county will report withheld amounts to either payees or the IRS, how often payments must be sent, or what penalties might apply to late payments or inaccurate reporting. He also questioned how it might apply to payments made through a third-party credit card bank.

Congressional staff familiar with the conference negotiations indicate that members of Congress intentionally applied the requirement to credit card payments to avoid creating a loophole, and for the same reason did not exempt small transactions from the requirement. However, they suggest that counties, cities and states might be able to work with the Treasury Department to determine a threshold to ease administrability without creating a loophole.

Congress did exempt certain payments from the law — specifically payments for interest and real property, payments to other governments, nonprofit entities or government employees, and payments in connection with a means-tested public assistance program or pursuant to a classified or confidential contract.

These exemptions may drive up costs, however, precluding automatic transaction coding and requiring county personnel to review individual transactions to determine whether they classify.

Sen. Larry Craig (R-Idaho) has introduced legislation to repeal this unfunded mandate on state and local governments as well as the withholding requirement for federal government vendors and contractors. NACo is working with his staff and is exploring options for repealing or mitigating the costs of this unfunded federal mandate.