

Section 511 – The 3% Withholding Requirement

by Devala A. Janardan, Associate Counsel

In 2006, when President Bush signed the Tax Increase Prevention and Reconciliation Act of 2005[1] ("Act"), much of the attention focused on the extension of tax cuts on capital gains and dividends for taxpayers.[2] A less publicized, but greatly troubling, portion of the Act is Section 511, which originally required that, as of January 01, 2011, federal, state, and local governments withhold three percent from payments to contractors for goods and services, and remit this to the Internal Revenue Service (IRS). The recent stimulus package – the American Recovery and Reinvestment Act of 2009[3] – provides for a one-year delay in the law's enactment, changing the effective date to January 01, 2012. The law applies to any government jurisdiction that spends more than $100 million annually on goods and services, but will not apply to the private sector. There is no minimum transaction threshold, and the only vendors or contractors that are exempted are other governments, nonprofit entities, and government employees.[4]

This government "withholding tax" for goods and services contracts is something that IMLA and other organizations – including the National Association of Counties, the Government Finance Officers Association, the National Council for Public Procurement and Contracting, the U.S. Conference of Mayors, the National League of Cities, and the International City/County Management Association – have worked to have repealed.[5] The requirement represents a significant unfunded mandate on state and local governments by burdening state and local entities with the responsibility of ensuring that government contractors comply with their *federal* tax obligations.

Implementing the law is sure to cause significant administrative and financial burdens (including the need to make costly programming changes to financial and accounting systems, and to keep documentation and reports), at a cost that one source estimates to be $62 million annually.[6] This financial burden is one that localities cannot afford in these constrained economic times. According to the National Association of Counties, the law:

> will also likely discourage contractors from bidding on government contracts and increase the costs of procurement. Many of its requirements are unworkable as written and will require the Treasury Department to issue 'administrability rules.' This mandate is particularly egregious because it was inserted into the final version of an omnibus tax bill that had already passed both the House and Senate and was never subject to a formal vote, hearings or consultation with any state and local government officials or their national organizations.[7]

For their part, contractors complain that the withholding: applies to the total contract, not to the net revenue generated from the project; is based on revenues from government payments with no relationship to a company's taxable income; and that contractors are likely to see "significant amounts of their operating funds become unavailable for periods that could exceed 16 months," with a particular impact on small businesses.[8] In addition, the American Council of Engineering Companies states that the profit margin for many public projects is often less than three percent[9] – not only will the withholding requirement starve companies of operating funds, it will force companies to utilize costly forms of credit. The possibility also remains that contractors will simply raise their bid submissions to include the cost of doing business within Section 511, creating more financial strain on states and localities.

Previous unsuccessful bills to repeal Section 511 and the three percent withholding requirement include H.R. 1023 (February 2007), introduced in the House by Representatives Wally Herger (R-CA) and Kendrick Meek (D-FL) and referred to the House Committee on Ways and Means; and S. 777 (March 2007), introduced in the Senate by Senator Larry Craig (R-ID) and referred to the Senate Committee on Finance. More recently, on January 07, 2009, Rep. Meek introduced H.R. 275, and on January 21, 2009, Sen. Arlen Spector introduced S. 292, The Withholding Tax Relief Act of 2009. As of June 15, H.R. 1023 was referred to the House Committee on Ways and Means in January and there has been no subsequent activity, and S. 292 had been read twice and referred to the Committee on Finance, with no further activity.

IMLA will continue to update members on the progress of this legislation.

Notes

1. Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222 (amending 26 U.S.C. §§ 179-6652 (2000)).
2. Press Release, White House – Office of the Press Secretary, *President Bush Signs Tax Relief Extension Recon-*

continued on page 39

Traffic Enforcement Issues

cont. from page 38

2009); S. 211, 95th Leg., 1st Reg. Sess. (Mo. 2009).
74. H.R. 300, 81st Leg., Reg. Sess. (Tex. 2009).
75. S. 59, 2009 Leg., Reg. Sess. (Ala. 2009).
76. S. 389, 116th Leg., 1st Reg. Sess. (Ind. 2009); A.B. 504, 75th Leg., Reg. Sess. (Nev. 2009); S. 2004, 2009 Leg., Reg. Sess. (Fla. 2009); H.R. 439, 2009 Leg., Reg. Sess. (Fla. 2009).
77. S. 277, 2009 Leg., Reg. Sess. (Md. 2009).
78. *See* theNewspaper.com, *New York Legislature Approves Massive Traffic Camera Expansion* (Apr. 09, 2009) at http://www.thenewspaper.com/news/27/2742.asp.
79. NCUTLO, *Automated Traffic Law Enforcement Model Law*, at http://www.ncutlo.org/autoenforce622.htm. ML

Federal

cont. from page 18

ciliation Act of 2005 (May 17, 2006).
3. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5.
4. National Association of Counties (NACo), *Toolkit on Repeal of New Non-Wage Withholding Requirement*, undated.
5. A letter sent to IRS Commissioner Douglas Shulman by a coalition of organizations, including IMLA, and urging the Commissioner to hold public hearings on Section 511, is available online at www.imla.org/irsletterimla.pdf.
6. GFOA Issue Brief, *Withholding Requirement on Government Payments and Other General Tax Issues* (Feb. 2009) states that "[i]n 2006, the Congressional Budget Office estimated the cost to state and local governments for administering this provision to be $62 million per year."
7. NACo Fact Sheet, *Repeal Three Percent Withholding Tax on County Purchases* (March 2007).
8. National Defense Industrial Association, *Little Known Legislation Takes Federal Contractors By Surprise* (March 2007).
9. Statement available at http:/www.acec.org/advocacy/committees09priorities /3percent.cfm. ML

Supreme Court

cont. from page 23

sorts. The Court placed great emphasis on test design and essentially held that a professionally prepared, content-valid test was a near impregnable defense to a Title VII disparate-impact lawsuit. Municipalities faced with adverse impact and the possibility of a lawsuit by minority candidates must now be prepared to stand by and defend their content-valid tests. At the same time, municipalities are free to explore selection procedures that have less adverse impact on minority candidates than traditional tests. The hope is that these alternative procedures will not only generate a more diverse promotion list, but will also do a better job of selecting candidates with intangible qualities, such as leadership, good judgment, and interpersonal skills. ML

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Inside Canada

cont. from page 28

the requester appealed. Section 6 (1)(b) provided that a record that revealed "the substance of deliberations of a meeting of a council, board, commission or other body or a committee of one of them if a statute authorizes holding that meeting in the absence of the public," was exempt from disclosure. To benefit from the exemption, the City was required to show that a statute – in this case, s. 239 of the *Municipal Act* – authorized the holding of the meeting in the absence of the public. That Act did so in the case of a meeting addressing "a proposed or pending acquisition or disposition of land by the municipality."

After reviewing the report at issue, the hearing officer concluded that the meeting (and consequently, the report) did not come within the "closed meeting" category because "most of the report" did not deal with "a proposed or pending acquisition or disposition of land" – "the bulk of the report contain[ed] background information and set[] out other options." There was, however, sufficient evidence to establish that council's actual deliberations at the meeting included the land disposition; thus, disclosing those limited portions of the report would have the effect of revealing the substance of city council's deliberations.

He concluded that only limited portions of the report qualified for exemption under s. 6(1)(b) of the MFIPPA (the portions addressing whether the City should dispose of the encroached-upon land to the requester and the position of staff on that issue), and that the remainder had to be disclosed. Second, he "also found that the City did not take all relevant factors into account when it exercised its discretion to withhold those portions of the report from the [requester]." These factors included whether the requester had "a sympathetic or compelling need to receive the information," and whether disclosure would "increase public confidence in the operation of the institution." Consequently, the City was ordered to re-exercise its discretion in this respect.

The CanLII website lists IPC decisions at http://www.canlii.org/en/on/onipc/index.html. The CanLII cites are, respectively, *Ottawa (City) (Re)*, 2009 CanLII 16569 (Ont. I.P.C.) and *St. Catharines (City) (Re)*, 2009 CanLII 29180 (Ont. I.P.C.). Both rulings are also available from the IPC website at http://www.ipc.on.ca. ML

Ordinances

cont. from page 29

nesses (other than restaurants) to conduct outdoor sales on their own property and adjoining streets or sidewalks, on a temporary basis, five times a year.
8. Christensen also claimed a violation of his rights under the Equal Protection Clause and the Fourth Amendment, but these claims were dismissed by the trial court and the dismissal was affirmed by the Tenth Circuit, so they are not discussed in this column.
9. 129 S. Ct. 808 (2009).
10. *See* Bery v. City of New York, 97 F.3d 689 (2d Cir. 1996); ETW Corp v. Jireh Pub. Inc., 332 F.3d 915 (6th Cir. 2003); White v. City of Sparks, 500 F.3d 953 (9th Cir. 2007). ML