

Part III - Administrative, Procedural, and Miscellaneous

Government entities required to withhold 3% on payments for services and property

Notice 2008-38

PURPOSE

This notice invites public comments regarding guidance to be provided to Government entities, Federal, State and local, required to withhold on payments made by the Government entities or their paying agents for services and property. See sections 3401(d) and 3402(t)(3). The new withholding is required by section 3402(t) of the Internal Revenue Code (the Code), which was added by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222 (TIPRA). Section 511 of TIPRA is effective for payments made after December 31, 2010.

The Department of the Treasury and Internal Revenue Service propose to issue guidance on compliance with the withholding requirements of section 3402(t). The Treasury and Service are requesting comments from all affected entities. The information collected will assist the Treasury and Service in drafting guidance under section 3402(t).

BACKGROUND

Under section 3402(t), all Government entities (except for certain small State entities) will be required to withhold 3 percent of all payments for services or property

made after December 31, 2010. Section 3402(t) identifies certain payments, such as payments that were already subject to withholding or payments that would not be subject to tax, as being excluded from the 3 percent withholding requirements. Except for those payments, all payments by affected Government entities, however made, will be subject to the mandatory 3 percent withholding requirements.

LEGISLATION

Section 3402(t)(1) of the Code provides that the Government of the United States, every State, every political subdivision thereof and every instrumentality of the foregoing 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.

Political subdivisions of a State (or any instrumentality thereof) making less than \$100,000,000 of payments for property or services are exempt from this requirement. See section 3402(t)(2)(G). There is no statutory exception for *de minimis* payments for property or services made by a Government entity (or any instrumentality thereof) that is not exempt from this withholding requirement.

Section 3402(t)(1) of the Code 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. See section 3402(t)(2)(H). For example, payments under Government programs providing food vouchers or medical assistance to low-income individuals are not subject to withholding under

section 3402(t). 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. H.R. Conf. Rept. 109-455, *109th Cong., 2nd Sess.*, at 301 (2006)

Section 3402(t)(1) of the Code 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. See section 3402(t)(2)(A). Section 3402(t) 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 section 3402(t) does not apply. See section 3402(t)(2)(B); H.R. Conf. Rept. 109-455 at 301.

In addition, section 3402(t)(1) of the Code 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 employees. See section 3402(t)(2)(C) – (F), (I). Section 3402(t) is effective for payments made after December 31, 2010. See section 511(b) of TIPRA.

The withholding requirement will apply regardless of whether the Government entity making the payment is the recipient of the property or services. For example, payments to a commodity producer under a Government commodity support program

will be subject to the withholding requirement. See H.R. Conf. Rept. 109-455 at 301.

REQUESTS FOR PUBLIC COMMENT

The Treasury and Service request comments on issues as to which Government entities and their paying agents will need guidance in order to implement the requirements of section 3402(t). The Treasury and Service are particularly interested in any comments regarding:

- How to apply the withholding requirements to purchases made with credit cards or other forms of payment cards;
- How to apply the withholding requirements if the payee is not subject to U.S. tax;
- How to apply the withholding requirements to partnerships and other pass-through entities in which a Government entity is a partner or owner;
- How to apply the withholding requirements to Government contractors and Subcontractors;
- The application of the withholding requirements to so-called Government – Sponsored Entities;
- The application of the withholding requirements to *de minimis* payments for property or services made by affected Government entities; and
- When and how the withheld amounts should be transmitted to the IRS.

Written comments should be sent to: CCPA:LPD:PR (Notice 2008-38), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Alternatively, comments may be hand delivered between the hours of 8:00

a.m. and 4:00 p.m. Monday to Friday to CC:PA:LPD:PR (Notice 2008-38), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. Comments may also be transmitted electronically via the following e-mail address: Notice.Comments@irsounsel.treas.gov. Please include "Notice 2008-38" in the subject line of any electronic communications.

All comments will be available for public inspection and copying.

Because Government entities will need guidance on compliance with section 3402(t) as soon as possible, comments, if any, must be received by **[INSERT DATE THAT IS 45 DAYS AFTER THIS NOTICE IS RELEASED TO THE TAX SERVICES]**.

DRAFTING INFORMATION

The principal author of this notice is Stephen J. Coleman of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice contact Stephen J. Coleman at (202) 622-4910 (not a toll-free call).