

How was this requirement enacted?

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), which was enacted May, 2006, created new subsection 3402(t) of the Internal Revenue Code. The measure is intended to increase compliance among taxpayers not subject to other forms of withholding or income reporting.

Are the rules final?

Proposed regulations were published December 5, 2008. There is a 90-day public comment period ending March 5, 2009. During this time, any comments or suggestions for implementing the final regulations, or requests for a public hearing, may be delivered, mailed, or electronically posted. All comments are available to the public. The procedures for making comments are provided in the regulations and at www.Regulations.gov.

Who must withhold?

The requirement applies to all federal and state agencies, regardless of size or amount of payments. Local governments and subdivisions are subject to the rules if, for a given year, total payments were \$100 million or more for the second preceding year.

What is included in “payments” for purposes of the \$100 million threshold?

All payments for goods and services, but this does not include wages and other payments to employees, other payments subject to other mandatory or withholding rules, interest, real property, payments on which backup withholding occurs, and payments to exempt organizations and other governments.

What payments must be withheld on?

All except the items listed above. However, individual payments of \$10,000, regardless of the purpose, are not subject to the withholding.

How much do I withhold?

The rate is 3% for all payees, regardless of any circumstances (line of business, profit margin, goods or services, etc.).

What do I do with the amounts withheld?

Amounts withheld are subject to the deposit rules for Form 945. These rules are the same as, but figured differently from, employment tax deposit rules. The total amount withheld is shown on Form 945 annually.

When does this start?

Any payments made after December 31, 2010 are subject to the withholding. However, transition rules generally exempt payments under contracts in existence at that time.

Can amounts withheld be credited against other taxes?

No. Amounts withheld are a credit only against income tax liability. They can not be applied to payer liability for employment or any other taxes.

What effect will this have on existing contracts?

Bona fide contracts in existence on the later of December 31, 2010, or six months after publication of the final regulations, are not subject to the withholding. The final regulations will address renewal of existing contracts.

Does withholding apply to all payees?

Tax-exempt organizations, other units of government, and foreign governments are exempt recipients. Passthrough entities with at least 80% ownership by these groups are exempt.

What if I fail to withhold?

Generally, the payer becomes liable for the tax if it is not withheld and otherwise paid by the recipient. Although the proposed regulations provide for transitional relief, penalties for failure to withhold and failure to pay may be applicable.

See the Regulations for more information.