

Three Percent Withholding Repeal and Job Creation Act

November 21, 2011

Special Report

HIGHLIGHTS

- Repeal Of Three Percent Government Withholding
- Hiring Incentives For Veterans
- Expanded Continuous Levy Authority
- VA-IRS Information Exchange
- Tax Gap Report
- Revised Health Care Program Eligibility

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Congress Repeals Withholding On Government Contractors; Expands Hiring Incentives for Veterans

President Obama signed the Three Percent Withholding Repeal and Job Creation Act on November 21. The new law repeals three percent withholding on government contractors and expands tax incentives to encourage employers to hire military veterans. The new law also expands the IRS's continuous levy authority, extends authority for the U.S. Department of Veterans Affairs (VA) to obtain information from the IRS and directs the Treasury Department to prepare a report on how to reduce the tax gap owed by federal contractors. HR 674 passed overwhelmingly in the Senate on November 10 by a vote of 95 to 0 and in the House on November 16 by a vote of 422 to 0.

The \$12.8 billion cost of repeal of government withholding and the veterans' tax incentives is off set by modifying the calculation of modified adjusted gross income (AGI) for determining certain federal health care program eligibility, as well as delaying scheduled reductions in fees for VA mortgage applications.

IMPACT: *HR 674 repeals the three percent government withholding requirement as if it had never been enacted. The withholding provision had previously been delayed several times. Most recently, the IRS delayed the withholding requirement until January 1, 2013. Critics of three percent government withholding had argued that the compliance costs to taxpayers would have outweighed any benefits to the federal government and privacy would have been compromised.*

IMPACT: *The hiring incentives for veterans are the first items from President Obama's proposed American Jobs Act to be passed by Congress. However, the prospects for passage of other measures in President Obama's proposed American Jobs Act in Congress before year-end are dim at best.*

GOVERNMENT WITHHOLDING

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) (P.L. 109-222) enacted a three percent government withholding requirement on certain payments to government contractors and others providing property or services. The mandatory withholding applied not only to payments by the federal government but also to payments by state and local governments as well as their political subdivisions. However, certain payments, such as interest, were exempt. Under TIPRA, government withholding initially had been scheduled to apply to payments made after December 31, 2010.

The American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) (P.L. 111-5) delayed by one year implementation of the requirement under TIPRA so that withholding would apply to payments made to government contractors after December 31, 2011. Implementation of government withholding was further delayed by the IRS in May 2011. Final regulations (T.D. 9524) delayed implementation of government withholding until January 1, 2013.

The final regulations also provided that withholding would not apply to payments by a political subdivision of a state (or any instrumentality of that political subdivision) that made less than \$100 million of payments for property or services annually (other than for payroll or of another type exempt from withholding under the regulations). Additionally, the regulations provided that withholding would not apply to any payment of less than \$10,000 (subject to an anti-abuse rule). The IRS also reserved the application of government withholding to payment card transactions for future guidance.

COMMENT: *In 2005, the Joint Committee on Taxation (JCT) estimated that government withholding would raise \$6.97 billion in revenue over 10 years. In 2011, the JCT estimated that repeal of government withholding will cost \$11.19 billion in lost revenue over 10 years.*

New Law. Under HR 674, government withholding is repealed as if it had never been enacted. Repeal of the three percent government withholding requirement is effective for payments made after December 31, 2011, which negates the 2009 Recovery Act's effective date.

HIRING INCENTIVES FOR VETERANS

The Work Opportunity Tax Credit (WOTC) rewards employers with a tax credit for hiring individuals from targeted groups. The WOTC was extended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) through the end of 2011.

Generally, targeted groups eligible for the WOTC as extended by the 2010 Tax Relief Act are:

- Families receiving Temporary Assistance for Needy Families (TANF)
- Qualified veterans (certain veterans receiving food stamps and certain veterans with service-connected disabilities)

- Qualified ex-felons
- Designated community residents
- Vocational rehabilitation referrals
- Qualified summer youth employees
- Qualified food stamp recipients
- Qualified Supplemental Security Income recipients
- Long-term family assistance (TANF) recipients

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New Law. HR 674 enhances the WOTC by creating the Returning Heroes Tax Credit and the Wounded Warriors Tax Credit:

- Employers that hire veterans who have been looking for employment for more than six months may be eligible for a Returning Heroes Tax Credit of up to \$5,600 per employee; employers that hire veterans who have been looking for employment for less than six months may be eligible for a credit of up to \$2,400 per employee.
- Employers that hire veterans with service-connected disabilities who have been looking for employment for more than six months may be eligible for a Wounded Warriors Tax Credit of up to \$9,600 per employee.

Depending on the employment scenario, employers may be eligible for a WOTC if they hire a qualified veteran receiving food stamps or a qualified veteran whose service-connected disabilities do not meet the criteria of the Wounded Warriors Tax Credit.

IMPACT: *The Returning Heroes Tax Credit and the Wounded Warriors Tax Credit apply to individuals who begin work for the employer after November*

21, 2011, the date of enactment of the new law and are scheduled to expire after December 31, 2012. However, HR 674 does not extend the December 31, 2011 sunset date on the WOTC provided in the 2010 Tax Relief Act for any targeted group, except for qualified veterans.

IMPACT: *HR 674 also makes the Returning Heroes Tax Credit and the Wounded Warriors Tax Credit, as well as the credits for veterans receiving food stamps and veterans with service-connected disabilities who do not meet the criteria for the Wounded Warriors Credit, available to tax-exempt employers. A tax-exempt employer for purposes of this extension is an organization described in Code Sec. 501(c) and exempt from taxation under Code Sec. 501(a). Additionally, HR 674 includes special rules for applying the enhanced WOTC for veterans in possessions of the U.S.*

Certification. State workforce agencies certify that an individual is a member of a targeted group to be eligible for the WOTC. Employers must complete Form 8850, Pre-Screening Notice and Certification for Work Opportunity Tax Credit. HR 674 includes provisions to expedite certification of an individual as a qualified military veteran. Generally, the state workforce agency will certify that the qualified veteran has been in receipt of unemployment compensation for the applicable period. HR 674 also allows the IRS to provide alternative methods for certification of a veteran.

COMMENT: *Form 8850 must be filed with the state workforce agency by no later than 28 days after the date the qualified new hire begins employment with the employer.*

COMMENT: *The Instructions to Form 8850 explain that an individual is a veteran for purposes of the WOTC if he or she served on active duty (not including training) in the U.S. Armed Forces for more than 180 days or was discharged or released from active duty*

for a service-connected disability, and did not have a period of active duty (not including training) of more than 90 days that ended during the 60-day period ending on the hiring date.

CONTINUOUS LEVY

Under Code Sec. 6331(h), the IRS is authorized to continuously levy specified payments made to, or received by, delinquent taxpayers. In the case of payments due to a vendor of goods or services sold or leased to the federal government, the levy may attach to up to 100 percent of the payment due.

New Law. Under HR 674, the IRS's continuous levy authority is expanded to reach all payments to a federal vendor, including property, as well as goods and services, effective for levies issued after November 21, 2011, the date of enactment of HR 674.

IMPACT: *The extension of continuous levy authority under Code Sec. 6331(h) will enable the IRS to levy 100 percent of any payment due to a federal vendor with unpaid federal tax liabilities, including payments made for the sale or lease of real estate and other types of property not considered goods or services.*

VA-IRS INFORMATION EXCHANGE

The U.S. Department of Veterans Affairs (VA) is authorized to verify a veteran's self-reported income with the IRS and Social Security Administration (SSA). HR 674 extends the

authority for the VA and IRS/SSA to share information through September 30, 2016.

TAX DELINQUENCY BY FEDERAL CONTRACTORS

HR 674 instructs the Treasury Department to prepare a report on methods to reduce the amount of unpaid tax owed by federal contractors. The Treasury Department will estimate the amount of delinquent taxes owed by federal contractors, the success of the federal lien and levy program in recovering delinquent taxes, and more. The report must be delivered to Congress.

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OTHER PROVISIONS

HR 674 also:

- Delays scheduled reductions in fees for VA mortgage applications
- Provides a number of non-tax initiatives to encourage employment and skills training for qualified veterans
- Allows members of the U.S. Armed Forces to begin the federal employment process before separation from service

HEALTH CARE OFFSET

Code Sec. 36B, enacted by the Patient Protection and Affordable Care Act (PPACA), provides a premium assistance tax credit for qualified individuals who obtain health insurance through a health insurance exchange after 2013. HR 674 revises the definition of modified adjusted gross income (AGI) under Code Sec. 36B to include the portion of an individual's Social Security benefits that is excluded from gross income. These include old-age benefits, disability payments, spousal benefits, child benefits, parental benefits, and Tier 1 Railroad Retirement benefits.

IMPACT: *For purposes of Code Sec. 36B, an individual's modified AGI is defined as AGI increased by any amount excluded by Code Sec. 911 (the exclusion from gross income for citizens or residents living abroad); any tax-exempt interest received or accrued during the tax year; plus the amount of Social Security benefits excluded from gross income.*

IMPACT: *Because the definition of modified AGI under Code Sec. 36B is incorporated by reference for purposes of determining eligibility to participate in certain other federal health care programs, the revised definition also applies to other programs, including Medicaid for the non-elderly and the Children's Health Insurance Program.*

COMMENT: *The IRS issued proposed regulations under Code Sec. 36B in August 2011 (NPRM REG-131491-10). The proposed regulations describe, among other provisions, eligibility for premium assistance tax credits.*