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## Final Transcript

### **INTERNAL REVENUE SERVICE: Q&A on IRC 3402(t)**

August 4, 2011/2:00 p.m. EDT

#### **SPEAKERS**

Tennille Francis  
Stephen Tackney

#### **PRESENTATION**

- |            |   |
|------------|---|
| Moderator  | Ladies and gentlemen, thank you for standing by and welcome to the Q&A on IRC 3402(t) Phone Forum. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session; instructions will be given at that time. As a reminder, today's call is being recorded. I would now like to turn the conference over to your host, Ms. Tennille Francis. Please go ahead, ma'am.   |
| T. Francis | Good afternoon, everyone, and thank you all for joining us for our first forum on IRC Section 3402(t). As you all know, 3402(t) requires all federal, state, and some local governments to withhold 3% of payment of \$10,000 or more for goods and services. The goal of today's call is going to be to provide you with as much information as we possibly can. We do recognize that we don't have all the answers to all your questions, but we're working to get you what you need so that you would be able to comply with the statute come January 1, 2013. |

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 2**

During this call, we are about 16 months out from the effective date so our goal is to ensure that you have enough information so that you're ready to start withholding. However, during the call today we'd like to answer questions that may be applicable to the general audience rather than the very fact-specific and unique issues. Though we would ask that you direct to the Ask FSLG site, which is located on FSLG's webpage via IRS.gov.

Along with that, you'll find at the FSLG webpage some recently posted FAQs on 3402(t) which should answer a number of your basic issues related to the statute.

Before we begin and open up the lines for questions, we have a few things that we want to touch upon and joining me today is Stephen Tackney from IRS Chief Counsel, and Stewart Rouleau, another Tax Law Specialist here in FSLG. We're going to work together to try to answer as many questions as you have.

Before we begin talking about some of the things that we just want to run down before we open the line for questions, we just want to make one point. In regards to statute repeal, we don't have any information regarding that. It's not an IRS issue and we would encourage you to contact your local congressman or congresswoman for any information regarding statute appeal—repeal, excuse me.

So with that, I'll turn it over to Stephen who has a few things that he would like to discuss, and then we'll get on with the question and answer period.

S. Tackney

Hi, this is Stephen Tackney. Thank you for having me as well. We just wanted to go—I just wanted to go over a few of the more common questions that we've gotten, so that hopefully that will clear those up and we can get some other questions and answers out there.

One of the first issues that we have gotten a lot of question on is exactly what entities are covered, and there was a misstatement in our webinar, our earlier webinar, so we just wanted to clarify: All federal government and federal government instrumentalities are covered and required to conduct withholding; all state government and all state government instrumentalities are subject to the withholding requirement; and then all political subdivisions of state and instrumentalities of political subdivisions of state are covered, but they are only covered if they meet the \$100 million annual payment threshold. So, again all state and state

instrumentalities are covered automatically; or local government, meaning political subdivisions, the local governments, and the local government instrumentalities are—can be covered, but again only if they meet the \$100 million payment threshold.

We did write an FAQ if you want to know which payments are included for purposes of that \$100 million payment threshold. You may want to look our FAQ on actually number one. So that's just to clarify that issue.

The next question we get a lot is how am I, as a contractor, if I do qualify for one of the exemptions from withholding, how will I claim that? For instance, tax exempt organizations are not subject to the withholding. Other federal, state, and local government entities are not subject to withholding. Indian Tribal Governments are not subject to withholding, for example.

So if I'm one of those how would I claim that? We are currently working on guidance to give you the exact details, but as we said in the preamble to the final regulations, we are looking at some type of statement or form, and/or form, it may actually be an either/or – we're looking at trying to make it as efficient as possible that basically you would provide the government entity payer to claim your exemption and that the government entity would be able to rely upon. But any further details we are working as quickly as we can to get those out.

We've also gotten some questions on how or does this apply to pass-through entities, meaning partnerships or S-corporations, for the most part. It does apply and the withholding could apply; there are some exceptions if the pass-through is at least 80% owned by exempt entities but if they do not meet that requirement then it can apply to them. Then the credit would be allocated under the normal rules governing allocations of credit and the owners or partners would then be able to claim that credit on their income tax return. And if they didn't owe any income taxes, would be able to claim a refund. So it can apply to a pass-through entity but it would be treated like any other credit with respect to the partners or owners.

Finally, we do have proposed regulations out there concerning the application of 3402(t) to outstanding contracts. Currently under the final regulations, it would apply only if they had been materially modified on the—under the proposed regulations it would apply to all contracts including existing contracts and regardless of whether materially modified

starting on January 1, 2014; that's what we proposed. We have just ended the comment period and we received a number of comments so we'll be looking through those comments and meeting and hopefully getting you out some regulations reasonably soon but I don't have any further details on that since the comment period just ended and we don't really start—we don't like to start discussing anything until we get all the comments in, so—but that process is ongoing.

So that's where we are on those issues and I think Tennille wanted to walk you through some of the more mechanical issues that we have also gotten questions on.

T. Francis

Yes. We received a number of questions regarding how to make the deposit of the withholding, how to report the deposit of withholding, both to the IRS and to the payee. So I just want to kind of walk through how I level those items and you will also find answers to those questions on FAQs located on the website.

But in regards to the withholding, the withholding is done at the time of payment. So once the payment goes out and it meets the threshold of \$10,000 or more, the payer must withhold the 3%. That 3% is then deposited with the service, and it should be deposited with all other non-payroll deposits, meaning any deposits you have related to Form 945. The 3% withholding deposits will go along with them.

The Form 945 is an annual return, and you will report all the withholdings on that form and submit that form to the IRS once a year which is done, and it's due to the IRS by January 31 of the succeeding year.

In regards to the deposits, the deposit rules, and the deposit schedules, the deposits for 3% again are likened to the non-payroll withheld amount that you do for maybe backup withholding. And the rules can be found in the regulations and they're at section 31.6302-4 and they will give you the rules for how to make the deposits and determine whether you're a monthly or semi-monthly or semi-weekly depositor.

Along with that you can read Publication 15; Section 11 of that publication will also provide you with additional information on deposits as well as the Form 945 instructions. So that should help you. Any other questions you have beyond that we would just suggest that you send them to the Ask FSLG website.

Along with that, in regards to what the payee will receive once withholding happens, the payee will receive a 1099-MISC which is a 1099-Miscellaneous form. The payer is required to provide this form to the recipient by January 31<sup>st</sup> of the succeeding calendar year. So for withholding done in January—for withholding done in the year of 2013, the succeeding year 2014 the payer is required to provide that form, the 1099 MISC, to the payee. And the payer will report on the 1099 in box 4 federal income tax withheld will be the amount of the 3%, the 3% withholding. And then in the other appropriate income box will be the amounts that were withheld upon. And then the payer is required to file that form with the IRS either by the last day of February, or March 31<sup>st</sup> if you file your forms electronically.

Lastly, I just wanted to let you know that the adjustment in regards to withholding amounts, whether over- or under-withholding, should be done as they are for employment tax. Generally, this means that all adjustments take place within the same calendar year. And for more information about those adjustment procedures, you can also see Publication 15 and Circular E, related to income tax withholding, not to be confused with regular employment tax like FICA or social security. So it's done with the income tax withholding adjustment procedures which can be found, again, in Publication 15.

So we wanted to highlight those items before we opened the line up, and if there's nothing else from this side operator you can open the line for questions.

Moderator

Thank you. We'll first go to Maureen Lonien.

M. Lonien

Hi there. My question is if you pay a vendor throughout the year for services or for items that you purchase from them, and an aggregate is \$10,000 do you withhold? Or is it just when it's a one-time payment of \$10,000?

S. Tackney

The threshold is applied on a payment by payment basis, so you look actually at each separate payment, and if that payment exceeds \$10,000 you would apply the withholding. Just so you know, the reasoning is that a number of these government entities will have multiple payment centers and what their comments to us were is that there wasn't really a way, on a real-time basis, to know when, as to an individual contractor you hit a specific threshold. So rather than apply it on a cumulative type of basis, this threshold for 3402(t) is applied to each individual payment.

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 6**

M. Lonien                    So just taking that one step further—so a regular, small business who buys construction material from another company, if they don't spend \$10,000 at a time then that 3% will not be withheld?

S. Tackney                    Yes; however the questions is—in other words if I basically invoice for a number of below \$10,000 items could I avoid withholding entirely? And the answer to that is yes, with a rather large caveat which is that there's an anti-abuse rule that if you are billing or paying with the specific intent of avoiding withholding, we will aggregate those payments.

M. Lonien                    Oh I didn't mean—

S. Tackney                    I understand—

M. Lonien                    What I mean is, and I can give you a perfect example. I've got—

S. Tackney                    No, no. Excuse me, I'll—just let me finish. So for instance if you are selling one particular item that is worth \$20,000 and rather than bill for that one item \$20,000 you bill, for instance, a \$6,000 on three successive days, for us that would look like an abuse and would aggregate that to the \$20,000. So on the other hand I do want to stress, because of the government entities have commented about this, that the standard is whether the government entity knew or should have known that the billing or invoicing or payments were being structured in this way.

So it's not necessarily that we expect government entities to do an incredible amount of investigation, but if it is very obvious in the sense of multiple billings for one item, or billings in a different manner than they've ever been done historically, that would certainly raise suspicions that in fact the billing has been done to get out of 3402(t) withholding.

Moderator                    And ma'am did you have any other questions?

M. Lonien                    No, I'm good. Thank you.

Moderator                    Thank you. I'm moving next to Barbara Hockenbrocht.

B. Hockenbrocht              I want to know these phone forums are they—can you get CPEs through doing this?

T. Francis                    Unfortunately this phone forum is not eligible for CPE.

B. Hockenbrocht      Okay. Thank you.

Moderator      And our next question will come from Carole Hedinger.

C. Hedinger      I just want to clarify that first question about the aggregation of payments. In the case of an entity, a government entity, a state entity that makes weekly payments to a contracted agent that will not aggregate to \$10,000 in some cases but may aggregate to \$10,000 in other cases, am I clear that we can go by the individual weekly payment made to determine whether or not to withhold?

T. Francis      The withholding, again, takes place at the time of payment so if you make one weekly payment for a number of invoices—if you make one disbursement to that contractor at the end of the week and that disbursement is \$10,000 or more you withhold; if that disbursement is less than \$10,000 then you don't withhold, regardless if it's for multiple invoices.

S. Tackney      But then you could have—so it could be though that you could withhold over several weeks and then have other weeks that you do not withhold. So again, we're not looking at any cumulative, we're looking at how big is that actual check.

C. Hedinger      Okay, thank you.

Moderator      We'll move to our next caller; that will be John Martin.

J. Martin      Hi, this is John Martin from GSA and I had a question about the credit cards. Under the final regulations, credit card, debit card, stored value and other payment cards are not going to be—we're not going to do withholding on the 3402(t); however, it goes down to—and that goes in line with the new 1099 regulations which says they'll be reported by the entity, the third-party entity, on a 1099-K. However, the final regulation goes on to say this relief does not apply to convenience checks issued in connection with the payment card accounts. Wouldn't the convenience checks be reported on the 1099-K, and if they are reported on the 1099-K wouldn't that be a duplicate reporting if we do it on a 1099-MISC?

S. Tackney      I—honestly I can't answer whether they would be on a 1099-K. I do know that convenience checks did not rise, have the same administrative

issues for the actual withholding so, but yes you are correct; withholding will apply to convenience checks.

For payment cards and debit cards and credit cards, what—just to avoid any confusion because we were actually trying to be generous, they are reserved under the final regulations at issue. It may be the subject of future guidance depending on, for instance, technological developments and other developments. But we wanted to let people know that we weren't going to surprise you so we promise that it will come out in proposed form for comment, and that if it is ever going to be applied to these types of payments, it won't be applied for at least 18 months from—the beginning of the year that is at least 18 months from the time we enact final regulations. So first of all, you'll get to comment on it and then when we finally release final regulations you'll have at least 18 months, if not two years, to be prepared.

So that's what that means, because we've had some question about that but I would have to—I honestly don't right now know the answer on the 1099-K, 6050W reporting on convenience checks.

- J. Martin                      So, if I understood what you said that not only the payment cards, debit cards, and stored value are exempt at this time; also the convenience checks are—and if you—if we decide at later date or if it's decided at a later date that has to be included—
- S. Tackney                    The convenience ... subject on January 1, 2013, credit cards, payment cards, stored value cards and anything that falls under the definition of a payment card that is not a convenience check wouldn't—is, for the moment, will not be subject to it and if it ever becomes subject it's ... at least a year and a half to two years to prepare. But convenience checks ... to this as of January 1, 2013.
- J. Martin                      And so the credit card companies will have to provide us that information, just like they provided that along with all the payment card information in the past.
- S. Tackney                    Yes, I'm not...1099-Ks or the 6050W regulations.
- Moderator                    And sir, did you have any other questions?

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 9**

- J. Martin                      No, it's just—very disappointing that we're going to have to do that because that's going to be a programming nightmare, both for us and the banks.
- Moderator                    And we'll move on to our next question is from Lance Siegall.
- L. Siegall                     Hi, this is Lance Siegall, Capitol Police. We are getting our ducks in row and finding out more about this for the—in preparation of issuing an increased number of 1099-Miscellaneouses due to all the withholding starting in 2013, if the—we're really talking about early '14 issuing the 1099s, what do you advise federal agencies or state as well as to be better prepared for that type of reporting because won't that require our verifying their EIN and insuring that we have all that necessary information, some of which we wouldn't necessarily have up front. We don't always get a 1099, I mean a W-9, but should we—should we be getting W-9s in addition to those that we have contracted with—we might have that information already but those that we don't necessarily have a full, a large contract with, we may not. So should we get 1099, I mean W-9s, a regular—starting now to be better prepared?
- S. Tackney                    I can't tell you when or give you advice on particularly any individual process as you should be getting people's EINs or TINs, I'm sorry, social security numbers or TINs depending on what type of contractor we're talking about here but to be able to do the 1099s. In addition, you should be aware that in certain instances if you don't have that information you should have been doing backup withholding, and if you do backup withholding 3402(t) withholding doesn't apply. Of course, it's a much higher rate of withholding.
- So I just want to make you aware that in some situations where you don't have this information you may have actually already had a backup withholding requirement. But it's probably—in which case it would obviously be easier if you just had the information but yes, you should have a tax credit identification number of some sort for all of your contractors at least to the extent you would think they, for instance, they—for individuals they would be subject to the regular 1099 process even if they're never going to receive a check of over \$10,000; they would probably get over \$600 and be subject to the regular 1099 process, so yes. If this only increases the need for that type of diligence.
- L. Siegall                     And we should rely on the Central Contractor Registry as much as possible to this end.

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 10**

- S. Tackney                    That you'll have to deal with your own agency and how they want to actually process that. We can't speak to any individual processes, either for the federal government or for the state and local.
- L. Siegall                    Okay.
- Moderator                    And we'll move on to Mark Harris for the next question.
- M. Harris                    Hello. I have a couple questions. I wanted to ask specifically about payments of— ... company and retention. There are situations here where we are paying contractors—let's say we pay a payment that is actually over the \$10,000 limit but it does ... with holds involved from pensions ... it falls below \$10,000. How is that handled? And the second part of that is when we do remit their retention or ... later, so how do we reconcile that ... we're in compliance?
- S. Tackney                    The threshold is based on the amount of the actual payment; we actually have an FAQ on retainage so if you were—for instance, if you have \$100,000 payment but you're retaining \$10,000 so it's a \$90,000 payment you would withhold on the \$90,000 you actually pay; then if the retainment is paid at that—well for instance the \$10,000 it just meets the threshold you would also withhold there. If it had been a \$5,000 retainage and that's all you pay, you wouldn't withhold. So we look at that actual amount. So you do take that type of retainage into account. You do not take the 3% withholding into account. So, for instance, if you owe \$10,200 withholding will apply and it's not like you would take the \$306 out and then say it fell below \$10,000. You do apply the \$10,000 threshold before you would apply the 3% withholding, but that's the only thing that you would take out.
- So, again if you are only—we are looking at the actual check and monies that are transferring, not necessarily the bill amount. So again if you're going to retain 10% and you're only going to pay 90% at that point in time, you determine both whether withholding applies and the amount withheld based on the 90% you actually pay.
- M. Harris                    Okay, just for clarification purposes. Again, if the payment let's say is \$10,500 but then we retain \$1,000 so we're only bidding for this contractor \$9,500 do we withhold or do we not withhold?

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 11**

- T. Francis                      Do not withhold. You only withhold on the amount that you pay out. So if you paid the \$9,500 that's below the \$10,000; there would be no withholding.
- M. Harris                      Thank you. I also have another question. Is it okay to ask the second question?
- T. Francis                      Yes.
- M. Harris                      Okay. LA Unified School District is a large organization and we—in our accounts payable department we have multiple payment processors that are processing payments simultaneously. There are situations where two processors could be paying payment to the same vendor unbeknownst to the other person; those conditions do occur. And we may have payments where both processors are actually paying payments that are less than \$10,000 but when you add it all up for that one day, maybe payment to that contractor is going out for over \$10,000 but again we—the processor was unaware that someone else was processing a separate invoice.
- S. Tackney                      We would apply that payment by payment. Again, I just want to make aware though the anti-abuse rules that you would want to be able to demonstrate that that was done for bonafide purposes and for instance you did—this wasn't supplying you one product but then invoicing two different payment centers for half of it to get below the threshold, that type of thing. Because it will look odd to us that you have two checks under \$10,000 on the same day going to the same person, but if it's for two different items and in the normal course of business being paid by two different payment centers, you would apply it based on the amount of that payment.
- M. Harris                      Actually what happens is our payments actually go through the LA County Office of Education; they actually cut the checks so when a check goes out it's going to actually be one payment because they're going to pick up that there's multiple payments to one contractor and they're going to aggregate those into one check; so the check they show—
- S. Tackney                      Then the check is above, then they would call it a bundled payment and we look at the amount of the payment. So we even if that check has—if there are 10 invoices where it's less than \$10,000 all being paid by one check that exceeds \$10,000 withholding applies.
- M. Harris                      Okay, but again the control—

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 12**

S. Tackney                      Doesn't matter; we're looking at the person cutting the check. And how much that check was for. So if it's one payment, you do that in one payment on one check and it's above \$10,000 it doesn't matter how—where that invoice came from or who processed that invoice, that's one payment and you would apply withholding.

M. Harris                      Okay, thank you.

Moderator                      And we'll go next to Brenda Arbaugh.

B. Arbaugh                      Yes. Could you repeat what the website was when you were talking about the 945; you mentioned a website where it had the FAQs, the Q&A.

T. Francis                      Yes, we post the frequently asked questions regarding 3402(t) and one of the questions addresses the Form 945, the depositing and the reporting, and that can be found if you to [irs.gov](http://irs.gov) and FSLG web—you can locate, access, excuse me, FSLG's website there and there is a link that will take you directly to the frequently asked questions.

S. Tackney                      And just so you know, FSLG stands for Federal State and Local Governments so it's actually [IRS.gov/govt/FSLG](http://IRS.gov/govt/FSLG) or there'll be a button on the [IRS.gov](http://IRS.gov) to get you there. But that's the website.

B. Arbaugh                      Thank you.

Moderator                      And we'll move next to Jim Kawamoto.

J. Kawamoto                      Hi, I'm actually a contractor and so just to make sure I got this right. So any work that my company does for a government agency 3% of the payment that would normally be coming is going to be withheld, correct?

T. Francis                      If that payment is \$10,000 or more, 3% will be withheld on it so you would get 97% of the payment and the other percent will be remitted to the government and it will be sitting there as a credit for you when you file your income tax return.

J. Kawamoto                      And so then that agency will send me, at the end of the year or soon thereafter, a 1099.

T. Francis                      Yes. And it will show you the amount that was withheld.

S. Tackney                      Now that's after the end of the year, so—

J. Kawamoto                    Correct.

S. Tackney                      Alright. But yes, so one way to think of this is similar to your income tax withholding for wages.

J. Kawamoto                    And then so, but I don't have to—if I'm doing work for a government agency I don't have to do any withholdings from any vendors or maybe subcontractors I would use?

T. Francis                      No. This—trickle down to subcontractors there's one point of withholding.

J. Kawamoto                    Okay, and then—maybe it's obvious to everyone else, but so what was the rationale of—why is this put in place I guess?

S. Tackney                      Well we're not really lent to speak to that as far as—well we'll let you know we just don't want to lead into—we're not wanting to speak on whether this is a wise policy or also whether it should be repealed and that process, but we will tell you that history of this indicates that it came out of studies involving the tax compliance of government contractors and that there were some compliance issues. So various measures were taken to ensure that tax compliance among government contractors was increased, and this was one of them—was to have those reporting and a 3% withholding.

J. Kawamoto                    Oh, so a possible issue somewhere else is causing an issue for others in this area.

S. Tackney                      Basically, yes. Well what we've heard is basically the noncompliant tax payers are creating an issue for the compliant tax payers. So as much as we sympathize, again, we just want to stress that we are not involved in the process of legislation or legislation to repeal, and we have to deal with the code that our congress gives us so while we receive many comments asking us to repeal it, we stay out of that. We would never, of course, have the power to do that. So we just have to deal the cards we're dealt and congress has enacted this part of the code.

J. Kawamoto                    That's it. Great, thank you.

Moderator                      We'll move next to Maria Corneanu.

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 14**

- Francine                      Hi. My name is Francine and I'm calling from Kent County. We purchased—we have a postage meter that we rent from a company and we purchase postage from them. We usually purchase \$30,000 worth of it at a time. Do we have to withhold 3% from that? How do we guarantee that we get our \$30,000 of postage if we're holding a 3% from our payment to them?
- S. Tackney                      Once again, I would presume that yes you are buying property from someone and if you're a government entity subject to this, and the amount's above \$10,000. Just to make sure everybody understands, this 3% is not a reduction in the purchase price; the 3% that's withheld is paid by you. It is then put over to the government and is a credit against income taxes. And again if income taxes aren't due then it's refundable.
- This is similar to income tax withholding on wages. It's not like your employer doesn't pay you the wages, it's that income tax withholding applies and then applies to your own individual taxes. So it is not a 3% reduction or a 3% tax on the vendor; it is a withholding of tax that is then applied towards their actual income tax amount due.
- Francine                      Well the issue we get here is we don't receive an invoice from them for this; we use a phone call to purchase this from them. So we don't have documentation saying that we—
- S. Tackney                      However you make your payment for your property through that, because I'm assuming you pay them at some point, you're going to need to address as far as having it able to both do the withholding and keep accounting of it because to file your 945 and 1099-miscellaneous.
- Francine                      I do have another question. When we pay utility companies and like phone bills and things like that, we're supposed to withhold from those payments also?
- S. Tackney                      Yes. If those are services or are—I mean a phone is a service, utilities is actually service. So yes, again if those payments exceed \$10,000—any payment to them that would exceed that would be subject to withholding.
- Francine                      Would it apply to renting of buildings and things like that? What about--?
- S. Tackney                      No, ma'am. Actually there is an exception for purchases of real property that covers also leases of real property; however, it does not cover

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 15**

construction of anything including permanent buildings. So there are certain exceptions you may want to be aware of. One of which is for real property which includes the leasing of real property.

Francine                      Okay, thank you. I was not aware of the exception for rentals; I did not see that part. I do have—what about when we pay insurance benefits for the employees? Those typically exceed \$10,000. Do we withhold on those payments also?

S. Tackney                      Again, I don't want to get into any specifics because I need to know how you've arranged that. I will tell you that any payment to an employee that is subject to regular income tax withholding is not subject to 3402(t) withholding. Also, contributions to employee plans such as your contributions you make to retirement plans are not subject to withholding.

Finally, a question that has arisen in the retirement planning context is there's also an exception for purchases of investment securities held for investment purposes. So typically the purchases by a qualified plan trust, even if that qualified plan is a government entity, a retirement plan, and they can be depending on how they're established, those purchases of actually the investment assets will not be subject to 3402(t) and also would not count toward the \$100 million payment threshold.

So whereas, for instance, payment if they were subject to this to withholding and are a government entity that's subject to withholding, payments for administrator services, if you have a third party administrator of your plan, could be again if they exceeded \$10,000 but the payments or asset purchases are not.

So a number of exceptions, one of them again is for anything that's wages or otherwise subject to employment—the income tax withholding, so yes. That's—hopefully that helped but again we can't—with that—will depend on the fact of your particular insurance arrangement so that may be one you'll want to want to email in.

Francine                      Okay. Actually it wasn't in regard to that. It was like we have—like dental benefits. Our employees go and they get their services and then monthly the third party administrator tells us how much we owe to pay the dental charges from all of the dental providers throughout the area.

S. Tackney                      You may want to send that in. We are looking at similar issues for future FAQs.

Francine                      Okay. I have one last question. We issue tax refunds to people who have property and their valuation has been reduced because they've gone in front of the board of review. And those payments are in excess of \$10,000 – do we withhold the 3% from property tax refund payment?

S. Tackney                      I would send that in. My—the one thing I'm wondering is, is there an actual purchase of property or services involved, but you may want to send that one in as well for more details, but I'm not seeing where you've actually purchased property or services, so—

Francine                      Okay. Yes, we do not purchase it at that point so I will send an email in. Thank you very much.

Moderator                      And we'll go to our next caller; that will be William Bell.

R. Bell                      This is Ron Bell. I wanted to know if I heard correctly that this withholding will apply to all contracts and that we will have to modify existing contracts?

S. Tackney                      Whether it applies to a particular contractor, in general, correct. It does apply to contracts as government entities that are subject to the withholding requirements. There are certain specific types of contractors that are taken out of this. For instances, tax exempt organizations, other government entities, Indian Tribal government, certain foreign entities are also taken out generally because they don't owe income taxes.

Then there are a number of exceptions for specific types of payment that are taken out. As I just mentioned, for instance, payments for real property. Payments subject to other types of withholding which generally takes out all of your payments to employees that are subject to income tax withholding. So you want to make sure you're not in one of those exceptions and there are several more. But if you are subject to this, then yes – you would be subject, a contract would be subject to this.

Currently, the current final regulations say that would be in effect on January 1, 2013, that a contract in existence as of December 31, 2012 would not be subject to this unless and until it is materially modified. So unless you modified the contract that was in existence, it would not be subject to this; however, we have proposed due to requests from certain government agencies other proposal that every contract would be subject to this as of January 2014, including those existing contracts regardless of

whether they had been materially modified. So the proposal is to make every single contract subject to it as of 2014. That is just a proposal.

The comment period just ended so I don't know if it will be adopted or not. If, again, if it is adopted then all contracts including existing contracts would be subject to this as of 2014 regardless of whether materially modified—all, new contracts would be subject as of January 1, 2013. If it is not adopted, which is the current rule, then all new contracts after January 1, 2013 will be subject to this and all existing contracts will be subject only if they are materially modified after January 1, 2013.

So I know that's a lot of dates flying around by I hope I was able to kind of answer where the boundaries are. And we also hope to finalize that reasonably soon so that you guys know what the lay of the land is.

R. Bell                      Okay, that may save a lot of work on the financial side but that's going to create a tremendous amount of work on the contract side.

S. Tackney                Basically as far as the proposed regulations what we have gotten in comment is the government entities it's going to be very difficult for them to divide up contracts between existing—previously existing contracts and new contracts. On the other hand, we've gotten comments from contractors saying, "When I'm negotiating these contracts, or have negotiated them, I'm not taking into account the withholding so you should not apply it to my existing contracts." So we have gotten comments on both sides of this issue and now we'll—that will need to go to the process of being considered in the decision-making process that tax regulations go through.

R. Bell                      Okay. Thank you very much.

Moderator                Our next question comes from Gwen Ross.

G. Ross                    Hi, this is Gwen Ross. I'm a public retirement system and I have a couple of questions. We have external money managers. I think you probably just answered this but investment-related expenses including money manager fees, master record keepers, investment advisory fees would be subject to withholding?

S. Tackney                Yes. Those are for services.

G. Ross                    Okay.

- S. Tackney If you are, yourself, a government entity subject to withholding, but yes.
- G. Ross Okay. And I think the webinar a couple weeks ago might have answered this but as far as health care expenses paid partially subsidized by the system for retirees, are those subject to the withholding?
- S. Tackney We are looking at that issue of how insurance purchases and direct payments for medical services for employees through plans, we're looking at that as right now, and we hope to have an FAQ out on that reasonably soon.
- G. Ross Okay. Somebody else kind of asked this, a similar question. Some of our vendors require us—we have to allow them to directly debit our account and we really have no control over the amount they debit. Would they have to reduce their—what they pull out of our account by that 3%?
- S. Tackney Again, you're going to have to put some controls on that that says if the debit is more than \$10,000 three percent will be withheld and deposited with the government under whatever deposit schedule applies to you. Because yes, there's not an exception based on how you actually pay someone.
- G. Ross Okay. How soon do you think that, like the health care question I asked will be resolved?
- S. Tackney Through many years of experience here I've learned I can do nothing but get in trouble if I answer that particular question. Because I'm bound to be wrong. So just know it is definitely on the table and I'm doing the best I can to get an answer out as soon as I can.
- G. Ross Okay, thanks so much.
- Moderator And Denise John has the next question.
- D. John Thank you. On utilities, when you have multiple accounts for utilities, such as different buildings have different accounts, we may be paying that on one check but they're different accounts or we may be issuing ten checks that week but it's to the same vendor but different accounts. Would that be subject to the 3% or would that—how would that be handled?

- T. Francis                      Again, the 3% is based on a payment by payment basis. So if the payment is going to the one vendor, whether it's for multiple accounts, is referred to in the regulations as a bundled payment, \$10,000 threshold would apply. If it's under \$10,000 then obviously there would be no withholding.
- D. John                         Okay.
- S. Tackney                      And to be more ... if you're paying for ten buildings with one check, we look at whether that check is over \$10,000. If you're paying each building separately, we look at each of those separate checks. So they're going to one vendor, but just know again you're going to have to be able to justify why, and you're in this process, are you writing those ten different checks. Are you actually getting ten different bills and is this a bonafide way of billing for those and a way for instance that is billed, that other non-government entities are billed, or is this a way of getting around the withholding.
- D. John                         Okay. And then I have a second question. On litigation, when you're paying legal settlements in lieu of a lawsuit, would those be subject to 3%?
- S. Tackney                      That ends up being very factual in the sense that often it will depend on what kind of payments you are making and what—in other words, what they're for. And we are also looking at an FAQ on that because, again, those types of payments can be made for various reasons. I will tell you that for instance, if it's a type of back wages payment that is subject to withholding, so for any reason it's subject to some other type of withholding, it would not be subject to 3402(t) withholding because there is an exception for that under 3402(t).
- With respect to the other type of payments, it's going to depend on what it's for and so we're hoping to do an FAQ that kind of lays out some of the more common types of these payments and whether they would be subject to the withholding or not. So unfortunately I can't really give you any more information, but again it would kind of depend on what you're actually—what are you paying, for instance, for compensatory damages, pain and suffering, loss of profit, whatever. A lot of it will depend on what is actually damages or other payments for.
- D. John                         Okay. Thank you very much.

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 20**

- Moderator And we'll go next to Jeffrey Revilla.
- S. Patel Hi, this is Samita Patel from Los Angeles County and our question is if we have a levy order or a garnishment, does the 3% withholding take place in lieu of the levy or do we do it together?
- T. Francis The 3% is on the gross amount of the payment. It would not take place after the levy, so the 3% is to be considered before any levy, garnishment, or any other deduction that would have to come out of the payment to have satisfy another obligation.
- S. Patel I'm sorry, you said 3% is after the levy?
- T. Francis The 3% is on the gross amount of the payment, and that would be before any levy, garnishment, or any other deduction that you will have to take out of the payment for another purpose. If the payment was \$10,000 the 3% would be applied to the \$10,000 and then you take the—whatever deductions you have to take out of the net amount.
- S. Patel And that includes, recently the state of California came out with a 7% withholding for nonresidents—
- S. Tackney Again, we're not really—we can't really give specific answers to that degree because that's normally done through other processes with the IRS. But in general, the general rule is all those types of offsets are done before—I'm sorry are done after you apply the 3% withholding. The 3% withholding is on the gross.
- S. Patel Okay. Thank you.
- Moderator Our next question will come from Ann Larue.
- M Hello. I have a couple questions and they're actually piggybacking off a couple of other questions that have already been asked. The first one is on retainage and I want to take that situation a little bit farther when we might have a payment retainage of \$10,000 that's given to an escrow bank and what we would then do is instead of the money getting paid directly by the government agency, we would release the bank to pay the \$10,000 to the contractor. So the withholding there took place on the first \$10,000 because it was retainage; but now we need to do something with this payment and so the ... is supposed to pay the contractor directly and so

the state never gets the money back to even accomplish withholding so do we take withholding on something like that?

S. Tackney

Again, we can't speak to the specifics because it will depend on the type of escrow. If for other reasons it would be considered, the payment for regular income tax purposes to that vendor would be considered made when it went into escrow, then that's the time you would do the withholding. But that may depend on the terms of the escrow and other terms of the arrangement, which we can't really get into here in the forum but so again if the normal income tax recognition time is because it went into escrow to the vendor then we would consider that a payment for 3402(t). If they in fact don't get that recognized as a payment for regular income tax purposes until it's released, then we would look at the time of the release. But that, again, may depend on the condition and structure of your escrow. So it's a little more involved and if you have any specifics you may want to, or even, can phrase it in a way that you think would be useful for an FAQ we would suggest sending it in.

M

Okay, and we are planning on doing that. And then our other question has to do with we talked about fees that we might pay to a financial institution and also for this would go with a ... to our state lottery department where the bank or the retailer will pick the gross proceeds and they will just send that money to the state, and they'll just peel their commission off the top. And so even though it might be a 3% withholding event, we never have control of the money on that. So how do we withhold or—

S. Tackney

Actually a question we are specifically looking at for an FAQ I will tell you however that there is a revenue ruling that at minimum you do need to be supplying a 1099 assuming this goes over \$600 so there's a very old revenue pre-3402(t) revenue ruling that says that is a payment for you for 1099 purposes, and we are looking at this and similar type of commission arrangements on how 3402(t) would apply and what processes you would need to use. So hopefully you should see that in an FAQ reasonably soon.

M

Okay. Thank you.

Moderator

We'll go next to Carol Cade.

C. Cade

Hello. I had a question referring contractors with a bond, like a performance bond. Because it is the contractor's money, like if they have a performance bond over \$10,000 in that we would issue a check to give

them their money back as when the work is completed. Is that subject to withholding?

S. Tackney                      Again, that's a similar issue where it can end up being very factually based on whether for regular, just income tax purposes, from the perspective of the contractor are they recognizing income when you put money into the performance bond or are they not. So that ends up being pretty factually specific because we would follow the timing of the income inclusion to the contractor. Since obviously I think we will take back from this phone seminar that that may be something, if either can provide an FAQ or we can point you to some other publications we have that discuss this as far the income timing to the contractor, that may be helpful. So I think that's been a good learning for us from the phone forum, but again it's going to kind of rely on other analysis of how income tax would apply from the perspective of the contractor.

C. Cade                          Okay and I had another quick question is for—I think you addressed it with utilities that it was pretty clear like for example you're using AT&T so if you're paying several accounts it doesn't matter, just as long as the payment to AT&T is over \$10,000 is subject to the 3% withholding.

S. Tackney                      Well again it depends. If you're bundling those payments—

C. Cade                          That's what I'm saying, like several accounts and then it's going on one check and it's over \$10,000 it's subject to the withholding?

T. Francis                      Yes.

S. Tackney                      It's not invoice-based, it's based on the check.

C. Cade                          The whole amount of the check.

S. Tackney                      Right.

C. Cade                          Okay. Thank you very much.

Moderator                      And at this time that does conclude all the time we do have for our Q&A session today. I would now like to turn the conference back over to our speakers for any additional or closing remarks.

T. Francis                      Thank you everyone. We really appreciate the questions. We got a lot of value out of it and we have some takeaways from here. We encourage

**INTERNAL REVENUE SERVICE**

**Host: Carol Watkins**

**August 4, 2011/2:00 p.m. EDT**

**Page 23**

you to go to the FSLG website and look at the FAQs and to submit additional questions and additional issues you'd like to see some information on in the future. That website is [www.irs.gov/govt/fslg](http://www.irs.gov/govt/fslg). And there you find the link for Ask FSLG and please submit your questions and comments there as well as the FAQs for 3402(t).

And that's all we have for you today, and we look forward to corresponding with you in the future. Thank you.

Moderator

That does conclude our conference for today. Thank you for your participation and for using AT&T Teleconference Service. You may now disconnect.