

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[REG-151687-10]

RIN 1545-BJ98

Withholding on Payments by Government Entities to Persons Providing Property or Services

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to withholding by government entities on payments to persons providing property or services. The proposed regulations reflect changes in the law made by the Tax Increase Prevention and Reconciliation Act of 2005 that require Federal, State, and local government entities to withhold income tax when making payments to persons providing property or services. These proposed regulations would change the provisions related to the effective date of the final regulations concerning these withholding requirements that are being issued concurrently with these proposed regulations. The guidance affects government entities that are required to withhold from payments to persons providing property or services and persons receiving the payments.

DATES: Written or electronic comments and requests for a public hearing must be received by August 8, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-151687-10), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-151687-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-151687-10).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, A. G. Kelley, (202) 622-6040; concerning submissions of comments or to request a public hearing, Oluwafunmilayo Taylor at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

This document contains proposed amendments to 26 CFR Part 31 under section 3402(t) of the Internal Revenue Code (Code). Section 3402(t) of the Code was added by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109-222 (TIPRA), 120 Stat. 345, which was enacted into law on May 17, 2006. Section 3402(t)(1) provides that the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) 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. Section 3402(t)(2) provides exceptions to withholding under section 3402(t).

Section 1511 of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5), 123 Stat. 115, 355, amended the effective date of section 3402(t) withholding. As amended, the statute provides that section 3402(t) applies to payments

made after December 31, 2011.

Notice 2010-91, 2010-52 IRB 915, provided interim guidance on the application of section 3402(t) to payments by debit cards, credit cards, stored value cards, and other payment cards.

Proposed regulations under sections 3402(t), 3406, 6011, 6051, 6071, and 6302 of the Code were published in the **Federal Register** on December 5, 2008 (REG-158747-06, 73 FR 74082, 2009-4 IRB 362) (the “2008 proposed regulations”). The 2008 proposed regulations proposed applying the withholding obligations to payments beginning on January 1, 2011, but proposed excluding payments made under contracts existing on January 1, 2011, unless those contracts were materially modified. The final regulations provide an additional one-year extension beyond the amended effective date of the statute. Thus, under the final regulations, the withholding obligation applies to payments made after December 31, 2012, and the exclusion applies to contracts existing on December 31, 2012, that are not materially modified on or after December 31, 2012. These final regulations under sections 3402(t), 3406, 6011, 6051, 6071, and 6302 of the Code (REG-158747-06, Treasury decision) are being published in the **Federal Register** concurrently with these proposed regulations.

Several commenters on the 2008 proposed regulations expressed concern that the requirement to differentiate between payments subject to withholding and payments not subject to withholding based on whether the payment was made under a contract existing on December 31, 2011, and whether that contract had been materially modified, would be burdensome to apply. In response to these concerns, these proposed regulations would provide that the exclusion for payments under existing

contracts that had not been materially modified would terminate with payments after December 31, 2013. Thus, these proposed regulations would subject payments under all contracts to section 3402(t) withholding after December 31, 2013, unless another exception applied. This rule would avoid the administrative burden of distinguishing between payments made under existing contracts and all other payments while allowing time to address concerns about applying the withholding requirements to existing contracts.

### **Proposed Effective Date**

These regulations are proposed to apply to payments made after December 31, 2011.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or

electronic comments that are timely submitted to the IRS. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or for public inspection and copying upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these proposed regulations is A. G. Kelley, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 31**

Employment taxes, Fishing vessels, Gambling, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

#### **PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE**

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 31.3402(t)-1 is amended by revising paragraph (d)(2) to read as follows:

§31.3402(t)-1 Withholding requirement on certain payments made by government entities.

\* \* \* \* \*

(d) \* \* \*

(2) Payments made under a written binding contract that was in effect on December 31, 2012, are not subject to the withholding requirements of this section for payments made prior to January 1, 2014. The preceding sentence does not apply to payments made under any contract that is materially modified after December 31, 2012. For this purpose, a material modification includes only a modification that materially affects the property or services to be provided under the contract, the terms of payment for the property or services under the contract, or the amount payable for the property or services under the contract. Notwithstanding the foregoing, a material modification does not include a mere renewal of a contract. A material modification also does not include a modification to the contract required by applicable Federal, State or local law.

The amendment to §31.3402(t)-1(d)(2) applies with respect to payments made after December 31, 2012.

Steven T. Miller

Deputy Commissioner for Services and Enforcement.