Government Finance Officers Association (GFOA)
International City/County Management Association (ICMA)
National Association of Counties (NACo)
National Association of County Treasurers and Finance Officers (NACTFO)
National Association of State Auditors, Comptrollers and Treasurers (NASACT)
National Association of State Budget Officers (NASBO)
National Association of State Retirement Administrators (NASRA)
National Council on Teacher Retirement (NCTR)
National League of Cities (NLC)
United States Conference of Mayors (USCM)

Committee on Small Business
United States House of Representatives
Hearing on "The New Hidden Tax on Small Business"
March 22, 2007

Chairman Velásquez, Ranking Member Chabot, and members of the Small Business Committee:

Our bipartisan organizations representing state and local governments nationwide applaud your decision to hold this hearing and appreciate the opportunity to provide written testimony on Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"). We applaud the committee for taking an interest in this critical federalism issue and urge you to cosponsor H.R. 1023, legislation introduced by Representatives Kendrick Meek (D-Florida) and Wally Herger (R-California) to repeal Section 511 of TIPRA.

Section 511 – which did not appear in either the House- or Senate-passed version of TIPRA but was used as a revenue-raiser in the conference agreement – will in effect impose a 3 percent federal sales tax on nearly every purchase made by a state and many counties and cities beginning in 2011. Businesses may claim this tax as prepayment of their federal income taxes in the following year. However, in effect, this tax will be only partially refundable for many small businesses. Our member state and local governments and public officials are extremely concerned about the impact this provision will have on competitive bidding for government contracts and the price that state and local governments will pay for purchases of goods and services. Many small businesses will simply refuse to do business with government; others will pass along the cost of this requirement.

The conference report on TIPRA acknowledges that Section 511 will impose an intergovernmental mandate with costs above the threshold of the Unfunded Mandates Reform Act. This will be the first time ever that federal tax withholding and reporting are imposed on the purchase of goods as well as services and the requirement only applies to the public sector. Aside from the increase in the cost of goods and services, it will also require states, cities and counties to reprogram or purchase new accounts payable systems, hire additional staff and essentially serve as branch offices for the Internal Revenue Service. In addition, since there is no minimum transaction on this provision, even a state, county or city employee who buys a $10 screwdriver will have to pay the hardware store $9.70 and send the remainder to the IRS.

This provision of TIPRA is absurd. Most of its $7 billion in revenue occurs in the first year and is due to an accounting gimmick whereby tax payments are accelerated into the prior year. After 2011 the Joint Committee on Taxation has estimated that the annual increase in federal revenue will be less than $300 million per year. The costs for state and local governments to comply with the requirement will likely exceed that amount.

If you have any questions about the impact of this provision on state and local governments or our support for H.R. 1023, please contact our Washington Representatives:

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Carolyn Coleman, NLC, 202-626-3023
Larry Jones, USCM, 202 861-6709