



April 24, 2008

CC:PA:LPD:PR (Notice 2008-38)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC

On behalf of the National Association of College and University Business Officers (NACUBO), and the associations listed below, we submit the following comments on Notice 2008-38. The notice addresses implementation of a requirement, added by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), for governmental entities, including public colleges and universities, to withhold 3% on payments for goods and services, beginning in 2011.

We understand that the Service's interest is limited to comments on how to implement section 511, and this letter will respond to the questions set forth in Notice 2008-38. However, we strongly believe it is important to express our grave concerns with the underlying statutory provision.

General Comments on Section 511

Enactment Without Analysis and Review. Section 511 was an eleventh-hour addition to an omnibus tax bill following passage of previous versions by the House and Senate that did not include the provision. The far-reaching mandate was not the subject of any hearings, votes, or discussions with any affected entities or their national associations. This sweeping requirement impacting federal, state, and local governments and their instrumentalities was enacted in the absence of any analysis, examination, and discussion with stakeholders. It is therefore not surprising that the resulting provision is so problematic.

Unreasonable Burden. Rather than identifying and focusing on the noncompliant contractors that the provision aims to bring into compliance, the blanket approach of Section 511 needlessly adds implementation costs to all governmental purchases of goods and services (as well as tax-compliant private companies). The extra costs of implementation will undoubtedly exceed the revenues the Joint Committee on Taxation estimated would be raised by section 511.

Impact on Higher Education. Congress appears to have imposed the new requirement on all public entities, without any consideration of the disparate impact it would have on state colleges and universities, and some of the larger community colleges. The

administrative and cost burden of compliance with section 511 will only affect public institutions, creating an uneven playing field in the marketplace. State support of public colleges and universities continues to deteriorate alongside mounting political and public pressure to keep tuition low. Section 511 will only increase financial strains on public institutions of higher education.

Marketplace Impact. Private companies selling goods and services to public colleges and universities will undoubtedly raise their prices in response to the implementation of section 511. It is anticipated that the cost for private companies of compliance with the new withholding requirement will be substantial. Their systems are not currently designed to track amounts withheld from invoices. Public institutions and community colleges could face a shrinking choice of suppliers as vendors decide to limit or eliminate the governmental segment of their market if the cost outweighs the benefits of doing so.

Recommendation for \$10K Payment Threshold

We strongly urge the Service to limit the application of section 511 to individual payments by governmental entities for goods and services that exceed \$10,000. This would eliminate the vast disruption caused by implementation of withholding on thousands of small transactions that would in turn yield small amounts of revenue.

One large public university has reported that payments equal to or less than \$10,000 accounts for 99% of the total transactions processed for goods and services and only 32% of the total dollars paid for goods and services. In other words, increasing the limit of reportable transactions to those in excess of \$10,000 will catch approximately 67% of the dollars processed by a large public university – but will reduce reporting on 99% of the transactions.

Responses to Questions Raised in Notice 2008-38

How to apply the withholding requirements to purchases made with credit cards or other forms of payment cards (p-cards):

According to Internal Revenue Bulletin 2004-31, T.D. 9136, Information Reporting and Backup Withholding for Payment Card Transactions, “Information reporting compliance is difficult in payment card transactions because an invoice may not be issued, and the employee representing the cardholder/payor in the transaction may not request and obtain the name/TIN combination of the merchant/payee at the time of the transaction. In addition, backup withholding may be difficult because a merchant receives payment from the payment card organization within a few days after the transaction, but the cardholder does not pay the payment card organization until after it receives a payment card monthly billing statement.”

However, in spite of the recognized difficulty, the IRS has proposed procedures on backup withholding requirements for payment card transactions made through a Qualified Payment Card Agent (QPCA). Under the QPCA program, a credit card

company is allowed to fulfill the backup withholding obligations of the payor of the transaction. At this date, QPCA organizations have not indicated a willingness to fulfill the withholding requirements of cardholders subject to the TIPRA 3% withholding requirements. Absent the participation of the QPCA, it would appear that payment through payment cards would be incompatible with the 3% withholding requirements.

Since universities do not normally own the software code that controls p-card transactions, universities would be dependent upon purchasing card processor/software owners to modify their software in order to withhold and track the withholdings. If the necessary modifications were not performed, withholding would have to be performed manually. The additional effort and cost of doing so would be significant. Furthermore, a reconciliation of the manual process would have to be implemented to ensure the correct withholding prior to the release of funds through the bank. The Service will also need to issue additional guidance regarding the application of withholding requirements to shipping and handling fees.

How to apply the withholding requirements if the payee is not subject to US tax:

Consistent with Congressional intent, no withholding requirement should apply to payees that are not subject to U.S. taxes. Internal Revenue Code Section 3402(t)(2)(E) excepts from this withholding requirement those organizations that are generally excluded from taxation, i.e. government entities, tax-exempt entities and foreign governments. Clearly, this exclusion should also apply to other taxpayers that are not subject to taxation.

Moreover, to exclude such payees from this withholding requirement is consistent with IRS reporting practices and reduces administrative burdens. Currently, taxpayers that are not subject to taxation do not receive tax forms. Thus, to impose a withholding requirement on payments made to these payees may require the IRS to make modifications to the Form 1099-MISC, miscellaneous income, or create an additional form that reports these withholdings but shows no taxable income. Also, the IRS will need to allocate resources to handle the additional filings that will result when these taxpayers file for the refunds to which they are entitled since they are not subject to taxation. In essence, applying withholding requirements to payees that are not subject to U.S. tax is counter-intuitive and creates unnecessary burdens.

How to apply the withholding requirements to partnerships and other pass-through entities in which a Government entity is a partner or owner:

We suggest that no withholding requirement apply to those persons who are excluded from this requirement when they are partners or owners in partnerships or pass-through entities and the government entity making the payment has knowledge of their status.

Clearly, this withholding requirement applies to partnerships and pass-through entities since they are defined as persons. However, the law excludes government and tax-exempt entities which may be partners or owners in these entities. Confusion and misapplication of the rule could result in government entities being withheld upon

erroneously. In that case, it is difficult to envision exactly how a government or tax-exempt entity would file a federal tax return (something most government entities do not do) in order to obtain the refunds they would be entitled to receive.

We understand the application of the law through the following two examples:

A state university is required to withhold 3% on the payments made to a consortium of state schools for services rendered in operating a foreign educational exchange program. However, in this scenario, no withholdings are required because the state university knows that each partner is excluded as a government entity.

A state university that makes a payment for medical services to a joint venture that includes the school, a hospital authority, and a private healthcare company. In this scenario, since the university knows that two of the three parties are excluded, it may withhold 3% on one-third of the payment.

We also recommend that the IRS provide assurance that certain payments related to investments are not within the purview of the 3% withholding requirement. Investments include (1) annual distributions made by colleges or universities as trustees to beneficiaries of charitable remainder trusts, (2) capital contributions made by endowments from colleges or universities to limited partnerships for investment purposes, and (3) capital contributions made by the college's or university's technology transfer office of intellectual property to a start-up company.

How to apply the withholding requirements to Government contractors and subcontractors:

Current government contracts do not contemplate the proposed withholding rule and its corresponding impact on a contractor's cash flow. Contracts written post-implementation will presumably consider the impact of the withholding rule by possibly accelerating payment timing, altering retention amounts, and/or adjusting the overall contract pricing. Application of the withholding requirement to all contracts executed after the implementation date of the withholding rule might help reduce complexity. Multi-year contracts in effect prior to the withholding implementation date are an area of concern. The best solution would be to exempt them from the withholding requirements until the earlier of the date a withholding-related contractual amendment is executed or some subsequent date.

The adverse cash flow impact on contractors is likely to bear an inverse relationship to the contractor's size. Since the use of small contractors, many of which are minority-owned, has been statutorily encouraged and creates a more competitive bidding environment, some mitigation of the withholding requirement impact for them would be in order. Specifically, we recommend a multi-year phase-in approach to the withholding requirement implementation based on size of the contractor.

The application of the withholding requirements to de minimis payments for property or services made by affected Government entities:

As stated above, we strongly urge the Service to apply the requirement to individual payments in excess of \$10,000. In the alternative, we suggest that IRS at least apply a minimum threshold of \$600 in keeping with the current 1099-MISC requirements.

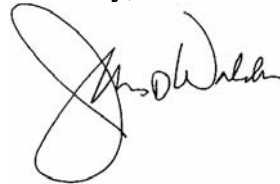
When and how the withheld amounts should be transmitted to the IRS:

We believe that withheld amounts should be remitted to the IRS no more frequently than on a quarterly basis. Initially, governments should be afforded until the end of the calendar quarter following the withholding month to remit the monies.

While a short-run manual alternative may be appropriate, ultimately, we believe the mode of transmission should be tied to the mode of transmission used by the government entity to transmit its payroll liabilities.

Conclusion. Although we will continue our work in support of full repeal of section 511, we thank the Service for the opportunity to provide comments on Notice 2008-38. If you have any questions, please contact Mary Bachinger, director, tax policy at 202.861.2581 or mary.bachinger@nacubo.org.

Sincerely,

A handwritten signature in black ink, appearing to read "John D. Walda". The signature is stylized with a large loop at the beginning and a cursive style for the rest of the name.

John D. Walda
President and CEO

Cc: Steven T. Miller, Commissioner, Tax Exempt and Governmental Entities

The associations listed below join NACUBO in these comments:

American Association of Community Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
National Association of State Universities and Land-Grant Colleges