CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 25, 2011

H.R. 674
A bill to amend the Internal Revenue Code of 1986 to repeal the imposition of 3 percent withholding on certain payments made to vendors by government entities

As reported by the House Committee on Ways and Means on October 18, 2011

SUMMARY

H.R. 674 would repeal a requirement scheduled to take effect on January 1, 2013, that government entities withhold a percentage of certain payments made to vendors, as a credit against the vendor's income tax. The staff of the Joint Committee on Taxation (JCT) estimates that enacting the legislation would reduce revenues and thus increase federal deficits by $11.2 billion over the 2012-2021 period.

In addition, H.R. 674 would reduce discretionary costs by eliminating the need for federal agencies to modify their accounting systems and to absorb the increased costs to vendors that are expected under current law. CBO estimates that repealing the withholding requirement would reduce discretionary costs by $7 billion over the 2012-2021 period, assuming appropriations action consistent with the bill.

Because enacting H.R. 674 would affect revenues, pay-as-you-go procedures apply. Enacting the bill would not affect direct spending.

H.R. 674 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 674 is shown in the following table. The costs of this legislation fall within multiple budget functions.

	By Fiscal Year, in Millions of Dollars											
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
CHANGES IN REVENUES												
Estimated Revenues[a]	0	-6,065	-546	-576	-600	-627	-653	-681	-709	-738	-7,786	-11,194
CHANGES IN SPENDING SUBJECT TO APPROPRIATION												
Direct Costs to Federal Agencies												
Estimated Authorization Level	-40	-50	-20	-20	-20	-20	-20	-20	-20	-20	-150	-250
Estimated Outlays	-20	-40	-40	-30	-20	-20	-20	-20	-20	-20	-150	-250
Increased Costs for Goods and Services												
Estimated Authorization Level	-180	-710	-1,050	-1,020	-690	-620	-700	-740	-760	-780	-3,650	-7,250
Estimated Outlays	-100	-450	-810	-940	-800	-700	-710	-740	-740	-760	-3,100	-6,750
Total Discretionary Changes												
Estimated Authorization Level	-220	-760	-1,070	-1,040	-710	-640	-720	-760	-780	-800	-3,800	-7,500
Estimated Outlays	-120	-490	-850	-970	-820	-720	-730	-760	-760	-780	-3,250	-7,000

Notes: Enacting H.R. 674 would not affect direct spending.

Components may not sum to totals because of rounding.

a. Negative numbers (for revenues) indicate increases in deficits.

BASIS OF ESTIMATE

For this estimate, CBO assumes the legislation will be enacted near the start of calendar year 2012, that appropriated amounts will be reduced accordingly each year, and that outlays will follow historical patterns for similar and existing programs.

Revenues

Under current law, federal, state, and local government entities will be required to withhold 3 percent of payments to vendors made in exchange for goods or services, beginning on January 1, 2013. The requirement will apply only if a government entity spends $100 million or more on all such payments to vendors annually. Payments made on contracts in effect on December 31, 2012, will not immediately be subject to the requirements. The staff of JCT estimates that repealing this requirement would reduce revenues by an estimated $11.2 billion over the 2012-2021 period.

Spending Subject to Appropriation

Federal agencies will incur additional expenses to implement the withholding requirements in current law. Operating costs of vendors with government contracts also will rise. CBO expects that vendors will raise their prices for goods and services sold to the government to recover those costs. By repealing the withholding requirement, H.R. 674 would eliminate those added costs, reducing the need for future discretionary appropriations. In total, CBO estimates that implementing H.R. 674 would reduce discretionary costs by $7 billion over the 2012-2021 period.

Direct Costs to Federal Agencies. Federal agencies are in the process of modifying their accounting systems to withhold the required amounts from vendor payments and to remit the amounts to the Internal Revenue Service (IRS), but agencies have deferred making significant expenditures because the implementation date of the withholding requirement has twice been postponed. Based on information from the Department of Defense, which accounts for over a third of all federal contracting actions, up-front implementation costs will total $80 million, CBO estimates. In addition, monitoring, reconciling, and reporting on the withholding transactions will increase agency expenses by about $20 million each year.

Increased Costs for Goods and Services. Vendors' costs also will increase as a result of the withholding requirement. While such expenses cannot be directly reimbursed on federal contracts, CBO expects that vendors will increase the prices of goods and services sold to federal agencies to recoup most of those increased expenses. CBO estimates that in total, implementing H.R. 674 would reduce discretionary costs for goods and services by $6.8 billion over the 2012-2021 period.

Administrative Costs. Vendors, like federal agencies, will incur both up-front costs to modify their accounting systems and recurring costs for additional labor hours to properly account for the withheld amounts and to recover them through their income tax filings.

Up-front implementation costs will vary widely; small contractors with basic accounting systems might need to spend only a few thousand dollars to train employees, while large firms could each spend hundreds of thousands of dollars to modify their complex accounting systems. Some of the 300,000 prime contractors that did business with the federal government in 2010 will choose not to do business with the federal government once the withholding requirement takes effect. Up-front costs for those that continue to do so will total about $3 billion, CBO estimates.

Because such a large number of companies contract with the federal government, CBO expects that recurring expenses for the vendors' additional accounting and tax filing time will be twice that of the federal government, about $40 million each year.

Financing Costs. The withholding policy will reduce payments from the government, effectively causing vendors to make tax payments to the government sooner than they otherwise would have, or make tax payments that they would not otherwise have made. Vendors will increase short-term borrowing to make up for that reduction in cash flow. CBO estimates that federal agencies will withhold about $15 billion of the $500 billion they spend annually on contracts for goods and services. Some vendors may be able to offset those additional collections by reducing their quarterly payments of income taxes to the IRS. Others will have to wait until they file annual tax returns to obtain a refund of the additional collections. Vendors will wait an average of six months to collect and incur about $400 million in annual interest charges, on average, to borrow the withheld amount, CBO estimates.

The costs incurred directly by federal agencies to implement current law will increase the need for discretionary appropriations in the year those costs are incurred. CBO expects vendors will gradually increase prices to recover their costs, increasing the need for additional discretionary appropriations over time. By repealing the requirement to withhold 3 percent of contract payments, H.R. 674 would eliminate the need for those discretionary appropriations. If total appropriated amounts were reduced accordingly, discretionary costs would decline by $120 million in 2012, by $3.3 billion over the 2012-2016 period, and by $7.0 billion over the 2012-2021 period, CBO estimates.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 674 as reported by the House Committee on Ways and Means on October 18, 2011

	By Fiscal Year, in Millions of Dollars											
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
NET INCREASE OR DECREASE (-) IN THE ON-BUDGET DEFICIT												
Statutory Pay-As-You-Go Impact	0	-6,065	-546	-576	-600	-627	-653	-681	-709	-738	-7,786	-11,194

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in UMRA.

PREVIOUS CBO ESTIMATE

On October 17, 2011, CBO transmitted a cost estimate for H.R. 674 as ordered reported by the House Committee on Ways and Means on October 13, 2011. That estimate included the effects on revenues and direct spending. It did not include the estimate of effects of the bill on spending subject to appropriation, as provided in this October 25 cost estimate.

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