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**AGC of America**  
THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA  
**Quality People. Quality Projects.**



March 20, 2009

The Honorable Daniel Akaka  
United States Senate  
141 Hart Senate Office Building  
Washington D.C. 20510

**Re: Cosponsor S. 292, 3 Percent Withholding Repeal**

Dear Senator Akaka:

On behalf of the Associated General Contractors of America (AGC), I am writing to urge you to cosponsor S. 292, a bill to repeal the 3 percent withholding requirement on government contracts. The law will require a significant overwithholding of payments to construction contractors which will cause an adverse impact on contractors' cash flow and will likely increase the price government entities pay for construction services.

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) mandates that federal, state, and local governments with total annual expenditures of \$100 million or more withhold 3 percent from all payments for goods and services, including payments made to contractors for public works repair or construction. AGC strongly believes that this requirement should be repealed. According to the Construction Financial Management Association's (CFMA) 2007 Construction Industry Annual Financial Survey, construction companies averaged 2.7 percent income before taxes on contracts. That means the government is withholding a percentage of taxes that is greater than the industry's average income before taxes.

Contractors are dependent upon a healthy cash flow in order to bid for and complete government work. Over withholding reduces the cash flow necessary for contractors to pay for materials, equipment, and labor to build a project, and it impacts the ability of contractors to obtain the bonds required by law that guarantee the contract will be completed. Surety companies, who provide these bonds, look at cash flow when deciding to cover a contract. Reduced cash flow leads to higher costs for bonds or the denial of coverage, all of which drives up the cost of construction and is especially threatening to the ability of small businesses to compete in the marketplace.

For example, a small business contractor may hold one government contract which is estimated to be completed in one year for \$10 million. The law requires withholding of 3 percent or \$300,000 on that contract. Meanwhile, the contractor expects to net approximately 2.5 percent, or \$250,000, after paying for supplies, services, subcontractors, and other ordinary business expenses. The tax owed on the revenue generated is at most 35 percent of the net income, which means that the maximum tax owed on the \$10 million project of \$87,500. Thus, the government has withheld \$300,000 to cover \$87,500 in tax liability. Furthermore, the same company would normally be required to maintain capital of \$1 million in order to perform the \$10 million contract. Since the government is taking \$213,500 of their capital out of circulation (21 percent of their equity), the company will either be required to raise these funds as additional capital or alternatively reduce the size of the contract they can perform down to \$8 million. Neither these outcomes is without cost to the industry and the government.


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If the 3 percent withholding law is not repealed, we can state with assurance that it will result in over withholding on every construction contract. Nowhere else in the tax system is a taxpayer required to prepay more than it reasonably expects to owe. Again, we believe that unless this law is repealed, the additional cost of doing business will adversely affect the construction industry and the price government entities pay for construction services.

Moreover, while the 3 percent withholding requirement is not set to go into effect until January 1, 2012, thanks to a one-year delay enacted in H.R. 1, the American Recovery and Reinvestment Act (P.L. 111-5), construction companies, as well as state, federal, and local governments, are expending funds starting to prepare for implementation now. These are needless preparation expenses, particularly during rough economic times. And, with companies facing narrower profit margins, the prospect of additional tax withholding diverts available resources away from business expansion activities, including workforce investment and equipment purchases.

That is why we ask you to cosponsor S. 292, sponsored by Senator Arlen Specter, to permanently repeal the 3 percent withholding law now. Repeal of this law is a top legislative priority of the 33,000 member companies of AGC.

Sincerely,



Jeffrey D. Shoaf  
Senior Executive Director  
Government and Public Affairs