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The Associated General Contractors of America

Repeal Excessive Withholding on Government Contracts

Section 511 Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222)

Background:

- Beginning 2011 federal, state, and local governments will be required to withhold 3% from all payments for goods and services as a guard against possible business tax evasion. The law:
  - Requires withholding of 3% on all government payments for products and services made by the federal, state, and local governments with total expenditures of $100 million or more.
  - Affects payments for goods and services under government contracts as well as payments to any person for a service or product provided to a government entity (e.g. Medicare, certain grants).

AGC Message:

- **Withholding Applies to the Total Contract, Not to the Net Revenue Generated From a Project.** For construction contractors, this means the government is withholding funds necessary to complete a project, such as those necessary to pay for materials and suppliers.
- **Less than 3% Profit on Most Construction Contracts.** Most general contractors, especially those working as Construction Managers, do not make 3% profit on a contract. This is 350% withholding on government construction contractors' net income until such time as the government repays what is owed. Nowhere else is one's full take home pay withheld as a cost of doing business.
  - For example, a small business contractor may hold one government contract which is estimated to be completed in one year for $10 million. This law requires withholding of $300,000 on that contract. Meanwhile, the contractor expects to net approximately 2.5%, $250,000, after paying for supplies, services, subcontractors and other ordinary business expenses. The tax on the revenue generated is at most 35% of the revenue, which means the maximum tax owed on the $10 million project is $87,500 (35% of $250,000). Ultimately, the government has withheld $300,000 for $87,500 in tax liability.
- **Tightened Cash Flow will Restrict Bonding Capacity.** The Federal law requires construction contractors carry several types of bonds. Surety companies who provide these bonds look at cash-flow when deciding to cover a contract. This withholding law will restrict cash-flow, leading to higher costs for bonds or the denial of coverage, all of which drives up the cost of the construction. In addition, the increased costs and difficulty in bonding will drive small businesses out of the market.
- **Enforcement of Current Laws would Ensure Tax Obligations are Met.** Existing laws require all corporations to make estimated tax payments towards their income tax liabilities quarterly and should be vigorously enforced. While the provision requires withholding for the purported purpose of ensuring taxes are paid, it does not require any additional enforcement or additional reporting in order to ensure bad apples aren't under-reporting income or over-reporting deductions.
- **Undue Burden on S Corps and Joint Ventures.** Withholding creates additional reporting burdens on S corps and other pass thru entities as those withholdings will need to be accounted for and reported to each partner in the partnership thereby impacting their tax returns and tax liability. The law could drive joint ventures out of the market, leaving large federal construction jobs with very few, if any, bidders. Joint ventures which are created to complete only one large project, such as the Woodrow Wilson Bridge, don't have a backup of savings, as the entity did not exist before the contract was bid. There are no reserves available to reach for when withholding exceeds costs to complete the contract.

Congressional Action Needed:

- Cosponsor and support H.R. 1023, sponsored by Representatives Kendrick Meek (D-FL) and Wally Herger (R-CA) and S. 777, sponsored by Senator Larry Craig (R-ID) to repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222).

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