



AMERICAN COUNCIL OF ENGINEERING COMPANIES

## Repeal the 3% Withholding Mandate

### ISSUE

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) is a sweeping new requirement mandating that federal, state, and local governments withhold three percent from payments to engineering firms and other contractors for goods and services. The law, which takes effect in 2012, will cover all payments for products and services made by the federal government and state governments, as well as local governments that have annual expenditures that exceed \$100 million.

ACEC is deeply concerned about the impact and unintended consequences of this new requirement on all companies that receive contracts or other forms of government payments. The provision was designed to deter tax evasion, but it will primarily penalize honest taxpayers and place unnecessary and onerous financial burdens on both small and large firms alike. In addition, implementing the provision will cost federal agencies and state and local governments billions of dollars. A Department of Defense study estimates that it will cost DOD alone \$17 billion in the first five years to comply with this mandate.

### KEY POINTS

- The withholding mandate will apply to the total cost of the contract, not to the net revenue generated or the size of the company. Many companies realize a profit margin of less than three percent on a contract, and withholding three percent up front for tax purposes will force them to divert funds needed to complete the contract, creating cash flow problems. As a consequence, government agencies may see the cost for goods and services increase as firms seek to offset the impact of the three percent mandate.
- The new mandate will have an especially onerous adverse effect on smaller firms, both in terms of creating cash flow problems as well as affecting the important role they often play as subcontractors on large government contracts. Prime contractors may be compelled to pass the costs associated with the three percent withholding requirement to their subcontractors, or possibly shift from subcontracting work out to self performance.
- The law will also impose significant administrative costs and information reporting requirements on governments and businesses. This will be a serious concern for subchapter S corporations and other pass-through entities because these withholdings will have to be reported to each partner in the partnership and will affect their tax liability.

### ACEC POSITION

- Cosponsor H.R. 275 introduced by Representatives Kendrick Meek (D-FL) and Wally Herger (R-CA) and S. 292 introduced by Senator Arlen Specter (D-PA) to repeal Section 511 and eliminate the 3% withholding mandate.
- Oppose efforts to broaden the withholding requirement or speed up its implementation.