

**DEFER NO MORE: THE NEED TO REPEAL THE
3% WITHHOLDING PROVISION**

HEARING

BEFORE THE

SUBCOMMITTEE ON CONTRACTING AND
WORKFORCE

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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DEFER NO MORE: THE NEED TO REPEAL THE 3% WITHHOLDING PROVISION

THURSDAY, MAY 26, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Mick Mulvaney (chairman of the Subcommittee) presiding.

Present: Representatives Mulvaney, West, Landry, Ellmers, Chu, Schrader, Kritz.

Chairman MULVANEY. I am going to call this meeting to order. I thank all the witnesses for being here today. We look forward to everybody's testimony.

I am pleased to spend this, which is my first hearing as a chairman of this Subcommittee, focusing on a government policy that is such a bad idea that when it was first enacted in 2006, Congress immediately delayed its implementation for five years. And when 2011 rolled around, Congress again delayed implementation of this 3 percent withholding requirement for another year. Now the IRS is causing further delays of the withholding requirements until 2013 because, as the IRS says, implementation of it would simply be too difficult, even though they have had six years to get ready for its implementation.

Since no one seems too interested in implementing this policy, hopefully this hearing can build on this Congress's successful bipartisan repeal of the 1099 reporting requirements and serve as the starting point for a congressional action to repeal this 3 percent withholding requirement. The original intent of this withholding was to close the tax gap. In other words, 3 percent withholding was supposed to reduce the amount of taxes that were owed by government contractors but that went unpaid. So in that sense it is very similar to the 1099 reporting requirements that we took up already earlier this year in this Committee and that this Congress subsequently repealed. Both the 1099 reporting and the 3 percent withholding requirements sought to close the tax gap through increased burdens on businesses of all types. But small business, as so often is the case, were hurt the most.

Small businesses today already operate on thin profit margins with little room for any additional withholdings. As has been discussed in this Committee regularly this year, regulatory burdens fall particularly harshly on small business. And the 3 percent withholding requirement would be no exception. Many small business

contractors, including those folks testifying here today, work for the government for less than a 3 percent profit margin. So the 3 percent requirement would force these contractors to wait until the end of the year, not only to get their profit but also to cover all of their costs.

Also troubling is the possibility that government contractors will not have the funds to pay their subs during a project and will have to find outside financing to complete projects. And I think all of us who are related or involved in the small business community these days know how much fun it is these days to try and get outside credit.

Even worse is the fact that implementing this 3 percent withholding requirement means treating all small businesses and their contractors with suspicion. Instead of rewarding those small businesses that choose to compete for and win contracts, the government essentially preaccuses them of cheating on their taxes. The government already requires all contractors to certify that they are in compliance with federal tax law. So one is left to wonder why we assume that they are going to break the law after they win a government contract.

Furthermore, there is a burden—believe it or not, this is so often the case in what we do in Washington—there is actually a burden on state and local governments as well. I look forward to taking the testimony today of the state—of the treasurer from my home state of South Carolina as to the impact on the states. And there is a very real impact on the states. It is yet another unfunded federal mandate in this 3 percent withholding requirement.

We also have witnesses from the Defense Department with us today to testify as to the great expenses that this withholding requirement will impose and how these expenses far exceed any projections for additional tax revenue. It makes absolutely no sense for the DOD to spend \$17 billion over five years to save less than \$6 billion on the first year and only \$200 million a year after that. The Joint Committee on Taxation has actually predicted that after the first year, all increases in revenues to the government from this proposed 3 percent withholding will come from interest that the government earns on the withholding. It is essentially forcing small business and other contractors with the government to float the government an additional 3 percent. It is completely outrageous and I look forward to hearing from the small businesses today that will testify as to the other ways that the 3 percent withholding requirement will affect them.

We have three really good panels today, but I also want to acknowledge all of the organizations that submitted information for the record. We have over 30 statements and I would love to read the list. There are about 35 organizations in here. I mean to slight nobody but this really is a who's who of American small business. Everybody who is involved in this industry from A to Z is just checked in on this 3 percent withholding bill and I really appreciate the effort that they have made. And this will be extraordinarily helpful to us as this Committee will—the testimony will be today in pushing this initiative further through this Congress.

Here is how we are going to work it today, folks. Ordinarily—oh, by the way, I ask unanimous consent that those be added to the record. And hearing no objection, it is so ordered.

Here is how we want to do it today before I recognize the ranking member. And I apologize for speaking very quickly. It is not something ordinarily we do in South Carolina, but I have been informed that we may begin voting today as early as 11:30. I have been through enough hearings in Washington to recognize what happens when Subcommittee hearings are interrupted by votes, which is that nobody comes back afterwards. And especially today, given the number of amendments that we may be taking up on the floor, these votes may take well over an hour and maybe possibly two or three. So in the interest of time we will be asking folks to try and stick to the five-minute limit. And we will not engage in as much back and forth as you ordinarily might hear from us because we do want to make sure everybody gets a chance to get their statements in the record.

So with that I recognize the Ranking Member Chu for her opening statement.

[The information follows:]

Ms. CHU. Thank you so much. I thank the gentleman from South Carolina, Chairman Mulvaney, for yielding.

Today's hearing will focus on an issue that could impact millions of small businesses across the country contracting with the federal government. The United States Federal Government is the largest purchaser of goods and services in the world purchasing more than \$425 billion per year. And small businesses play an integral role in meeting the needs of the federal government. In fact, federal agencies are required to establish contracting goals with a total of 23 percent of all government buying targeted to small firms.

Therefore, any policy that could hamper the ability of small firms to do business with government must be looked at carefully. While there is often little agreement in Congress on many policies, there is bipartisan consensus that the issue of the 3 percent withholding requirement on all government contracts needs to be addressed. The original intent of the law was to prevent government money from going to individuals and companies with outstanding tax debts. However, as the law was written, the withholding will apply to virtually all contractors, even if they do not have a tax liability or other delinquency.

Like the 1099 filing requirement that was recently repealed by Congress, the reasoning behind the 3 percent withholding requirement was to increase tax compliance and reduce the tax gap. However, this is another instance where a broad brush approach has harsh consequences for small firms. First, 3 percent of a contract often represents the estimated profit or operating cash flow for small firms in the construction industry. This money could be used by contractors to compensate for material costs, supplies, and other operating expenses. The withholding requirement will force many small firms to divert funds needed to complete a contract, creating cash flow problems. At a time when small firms are still having a hard time accessing credit from banks, laws like this create another barrier for small firms seeking to do business with the government. The new mandate will have an adverse effect on the

smallest of firms since many prime contractors may be compelled to pass the costs associated with the 3 percent withholding requirement to their subcontractors.

Additionally, government agencies have voiced a concern that administering the 3 percent withholding requirement will create more costs than benefits. The Department of Defense issued a report that implementing this could cost \$17 billion for the first five years alone, far outweighing the revenue brought in. State and local governments have also actively fought to repeal the 3 percent withholding since it represents an unfunded mandate at a time when state and local budgets are stretched to the limit. In fact, many state and local agencies do not have the internal processes and systems to withhold payments and track them. Although the implementation of this law has been delayed, now is the time to fully repeal this onerous provision.

At a time when America needs to promote economic activity, the 3 percent withholding only hampers transactions between businesses and the government. If Congress does not act, businesses will face additional paperwork every time they sell goods and services to the government. As the economy continues improving, small businesses need to focus on what they do best, developing innovative new services, bringing additional products to market, and creating jobs. And while it is important to enact policies that ensure taxpayers are paying their fair share of taxes, overreaching policies do not serve that purpose. There is bipartisan support for this repeal and doing so will allow small firms to continue to perform quality work on behalf of the public.

With that I would like to welcome Congressman Herger to the Committee, as well as the witnesses who have taken time from their busy schedules to testify here today.

I yield back.

[The information follows:]

Chairman MULVANEY. Thank you, Ms. Chu.

Very briefly, just for the folks who have gathered here and for the folks especially who are here for the first time, including the folks who are testifying for the first time, why are we here? We are here to sort of take the testimony and build a record. It is the job of this Committee to take information about Mr. Herger's bill that we will hear about in a few minutes and then make recommendations and report back to the Ways and Means Subcommittee with hopes that they will then approve this bill, bring it to the floor so that we can vote on it, and then send it to the Senate.

Towards that end, you saw the book that we have. That is part of the record. The other record will be made up today by the testimony of the three different panels.

STATEMENTS OF WALLY HERGER, U.S. HOUSE OF REPRESENTATIVES; CURTIS M. LOFTIS, JR., TREASURER, STATE OF SOUTH CAROLINA; BRIAN GEORGE, DEPUTY DIRECTOR, OFFICE OF COST, PRICING AND FINANCE, U.S. DEPARTMENT OF DEFENSE; MIKE MURPHY, PRESIDENT, TURNER MURPHY CONSTRUCTION, ASSOCIATED GENERAL CONTRACTORS; IAN FROST, PRESIDENT, EEE CONSULTING, INC., AMERICAN COUNCIL OF ENGINEERING COMPANIES; JAMES M. GAFFNEY, PRESIDENT, GOSHEN MECHANICAL, INC., QUALITY CONSTRUCTION ALLIANCE; KARA M. SACILOTTO, PARTNER, WILEY REIN, LLP

Chairman MULVANEY. And our first panelist is our colleague, Congressman Wally Herger. He serves on the House Committee on Ways and Means. In that role, his primary legislative concerns include security economic growth and encouraging innovation and entrepreneurship by reducing the tax burden on America's families and small business. He is also interested in making government run more efficiently by reducing federal regulatory burdens and spending and responsibly reforming entitlement programs to make them sustainable and ensure that they will be around for the future generations.

Congressman Herger is the sponsor of H.R. 674, of which I am proud to be a co-sponsor, and which seeks to repeal the 3 percent withholding provision which is the bill we are here today to discuss.

Congressman, welcome. And we look forward to your testimony.

STATEMENT OF WALLY HERGER

Mr. HERGER. Chairman Mulvaney, Ranking Member Chu, and members of the Subcommittee, thank you for holding this hearing on the need to repeal the 3 percent withholding tax on government contracts.

As someone who has been passionately opposed to this tax from the day it was first signed into law, I am encouraged by the Committee's interest in this issue. Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 requires government agencies at all levels—federal, state, and local—to withhold 3 percent of payments for goods and services effective in 2012. The Internal Revenue Service has recently issued regulations delaying this requirement until January 1, 2013, but agencies and businesses must still plan for it to eventually take effect. The breadth of this 3 percent withholding tax is truly astounding. It affects everyone, from the manufacturer who builds tanks for the Army, to the nursing home that cares for poor seniors on Medicaid, from the construction workers who repair roads and levees, to the commissaries that sell groceries to families on military bases.

As the members of this Subcommittee are well aware, small businesses are the lifeblood of our economy. I come from a small business background myself, so I have firsthand knowledge of how our country's entrepreneurs and job creators are burdened by a complex tax code and cumbersome regulations. If the 3 percent withholding tax is permitted to go into effect, it will only add to that burden. Many businesses that contract with the government operate on very narrow profit margins, often less than 3 percent. As a

result, this tax will create serious cash flow problems for small businesses.

Today our economy is in poor condition. The stock market may have improved from the low point of the recession but for most Americans the signs of recovery have been few and far between. Millions of people are still without work. In my Northern California congressional district, some counties have more than 20 percent unemployment. Government regulations and taxes that were a bad idea even in happier times are absolutely disastrous when our economy is struggling to recover and create jobs.

In addition to its impact on small businesses, the recession has also taken a toll on state and local government finances. Cities, counties, and states across America are struggling to balance the budget without raising taxes or slashing vital services. The 3 percent withholding tax would worsen this fiscal crisis by creating new administrative costs and potentially raising procurement costs for state and local governments.

Supporters of the 3 percent withholding requirement have billed it as a tax-compliance measure. Yes, it is a problem when government contractors do not pay their taxes. But instead of slapping a new tax on everyone, a tax that will actually cost the government more to collect than it raises in revenues, we could simply stop awarding government contracts to people who cheat on their taxes. In fact, since the 3 percent withholding provision became law, OMB and Treasury Department have announced several initiatives to do just that. Hopefully, these new compliance measures will provide the final push for Congress to repeal 3 percent withholding once and for all.

Again, I appreciate the opportunity to testify this morning, and I look forward to working with the chairman and other members of this Committee to move ahead with repeal.

[The statement of Mr. Herger follows:]

Chairman MULVANEY. Thank you, Mr. Herger. Very briefly, I have one question. It just came up and was presented to me a day or two ago when I was talking about this bill.

And I think there was a GAO report that came out last week or early this week that indicated that there were as many as 37 recipients of grants or contracts under the Recovery Act who owed taxes. Thirty-seven hundred folks who got government contracts or government grants under the stimulus program actually owed taxes. And I think the total amount that they estimated that they owed was \$750 million. So the question was put to me and I will put it to you, which is against that background, why is this bill still a really good idea?

Mr. HERGER. Well, again, I do not think it is—first of all, everyone should be paying their taxes and we should be moving in a judicious way that makes sense to ensure that those who are not paying their taxes do. We might point out this is a small percentage that do not pay their taxes. We should not be penalizing the masses who do pay their taxes just for those who are not. I believe the government has taken steps to correct this. We need to take further steps. As a matter of fact, one quarter of those who did not pay their taxes we were able to find out and we were able to deal

with and again, there are more judicious ways to do this than penalizing everyone.

Chairman MULVANEY. Thank you, Mr. Herger. I yield now to Ms. Chu for any questions.

Ms. CHU. Congressman Herger, the repeal of the 3 percent withholding seems to have broad bipartisan support. It is clear that both parties want this fixed and small businesses want it done quickly. And the title of this hearing is Delay No More: Repeal. So when does your Committee anticipate marking up this bill or taking any other substantive action to repeal it?

Mr. HERGER. Chairman Camp, chairman of the Ways and Means Committee, has indicated his support. As you know, there is a lot going on in Ways and Means now with health care and a number of other areas. So we are—the fact that we are having this hearing today, the fact of the growing support around the nation I think helps put this more to the importance of bringing this sooner than later that we will have a markup on it in Ways and Means.

Ms. CHU. Chairman—well, I actually have another question.

Congressman Herger, we know that when companies do not pay their fair share of taxes it creates an unlevel playing field. I believe this measure was enacted as a tax gap proposal. Do you believe that there are measures that could be put in place to close the tax gap and help level the playing field for honest small businesses? If so, could you share some of those with us?

Mr. HERGER. Absolutely there are. And I think we are moving towards it now. As I mentioned, one-quarter of that amount that we indicated that had not been paid, by new measures that have been put into place we have already been able to determine those one-quarter. And we need to continue taking stronger measures. But a measure like the 3 percent, that penalizes everyone. The masses who are paying their taxes is not the way to go about this and we need to keep the pressure on so that everyone pays their taxes.

Ms. CHU. Thank you. I yield back.

Chairman MULVANEY. Thank you. I recognize the gentleman from Florida, Mr. West, for up to five minutes.

Mr. WEST. Thank you, Mr. Chairman.

My colleague, Mr. Herger, I only have one question. You know, having served 22 years in the United States military and retiring thereof, and of course when you talk about the effect upon commissaries and exchanges, do you see that possibly with this 3 percent withholding tax, that the Department of Defense may then push the cost against the individuals who are using the commissary and exchanges to include our retiree community?

Mr. HERGER. I do not think there is any doubt about that. This will increase the cost to commissaries and I am sure that this cost—it would be very difficult. As you know, the military is running very frugally now and I think it is very likely that these costs will be passed on. And therefore, our men and women in the military will have to pay more than they would otherwise.

Mr. WEST. Thank you, Mr. Chairman. I yield back.

Chairman MULVANEY. Thank you. I recognize the gentleman from Louisiana, Mr. Landry, for up to five minutes.

Mr. LANDRY. Mr. Herger, I am just curious—whose brainchild was this in 2005? I know this—it originated in the Senate. It was

something that was tagged onto a legislation in the latter hours going through. Part of an omnibus pay-for. You do not know who in the Senate—

Mr. HERGER. Well, I think it is public knowledge who has been supporting this.

Mr. LANDRY. I do not know. That is why I am asking.

Mr. HERGER. It came through the Finance Committee of the Senate.

Mr. LANDRY. Because it just seems to me that this automatically increases government's cost. I mean, companies who are operating on thin margins and need cash flow, when they are going to bid on these projects they are going to have to factor this in. So that just increases our costs. I am just trying to figure out as a freshman here how people come up with ridiculous legislation like this.

Mr. HERGER. Well, giving them the benefit of the doubt I have to believe that it was well meaning. I am sure they thought, well, we will just withhold 3 percent. That way we will make sure that we collect it. But again, I think it is obvious as we look at it and analyze it, it was something that was not well thought out. And certainly as we are hearing from our small business people. And not just the small business, but as was mentioned, just the Department of Defense. It was estimated it was going to cost them an additional \$17 billion to implement this. So I think as we analyze it, something that might have started off well meaning, certainly we can see the repercussions are very, very derogatory and negative and something we need to correct sooner than later.

Mr. LANDRY. But what I do not understand is they must have known it would have had some sort of impact because they kicked the can down the road to 2010. And then of course they realized that it was a problem and they kicked it down again and now it is in our lap. I am trying to figure out, you know, I guess what they think about when they pass legislation like this. I know it is like a feel-good piece of legislation telling the American people that, you know, we are going to do something for tax cheats when really what we should be doing is letting the IRS go in and enforce those provisions. So I was just—I was trying to get a little bit—I know you have been here for a long time and so I am trying to get some wise advice, I guess, today.

Mr. HERGER. Mr. Landry, I think the wise advice is coming from new members like yourself that have been out in the real world. I think the bottom line is as has happened so often, well meaning legislation many times has not been thought out and how it really affects regular people that are out in America trying to make a living for their family, trying to grow their business and hire new people.

This is certainly one of those, I would say, pieces of legislation that was intended to collect taxes that were not being paid that I believe was not thought through very well at the time. It might have been—I am sure it was well meaning. I have to believe it was well meaning at the time, but we can certainly—what is important is that at this time we can see it is not working. It is very harmful to small business at a time when we need to be growing jobs and expanding our economy. This is the type of legislation that is working exactly in the opposite direction.

Mr. LANDRY. Well, I want to thank you because that is why I came to Congress, to vote on legislation just like this. So I certainly hope that Ways and Means takes it up.

Thank you. I yield back.

Chairman MULVANEY. Mr. Herger, thank you again. I appreciate you coming in, and thank you for offering the bill this year.

Mr. HERGER. Thank you. And again, I want to thank this Committee. I want to thank you, Mr. Chairman, who also is a new member. I compliment you for being chairman.

Chairman MULVANEY. And a small businessman, so I really appreciate it.

Mr. HERGER. A small business one. And this is the type, as well as Mr. West and some others, this is the time to correct this. Thank you for your emphasis. Working together we will repeal this.

Chairman MULVANEY. Thank you, Mr. Herger.

I will ask the Committee to go ahead and begin to seat the second panel if we can.

And while the second panelists are coming up, a word to all of the panelists. There are those little crazy lights in front of you. They are green, yellow, and red. It will be green for the first four minutes, yellow for the second minute, and then turn red. We usually do let you go a few minutes beyond if you like. Today we would like, again, to try and keep as close as we can because of the time constraints that we are under. If you start to hear this tapping motion, that means that we are asking you to please wrap things up as quickly as you possibly can.

The second panel has two government witnesses. First, I am pleased to welcome Mr. Curtis Loftis, Jr. Mr. Loftis was elected treasurer of the great state of South Carolina in November of last year. In this role, Mr. Loftis is responsible for the investment, cash management, and safekeeping of the state's general and restricted funds, and also the assets of the South Carolina Retirement Systems. He also serves as the vice chairman of our State Budget and Control Board, which handles the State Procurement programs, state insurance, the Budget office, the State Auditor's office, State Human Resources office, the General Services offices, the Budget office, and the State Technology office. Prior to running for office, Mr. Loftis owned and operated a very successful small business in West Columbia. Welcome Mr. Loftis.

I would also like to welcome at the same time our second witness, Mr. Brian George. He is the deputy director of the Office of Cost, Pricing, and Finance, Defense Procurement and Acquisition Policy, where he is the lead for reinvigorating costs and pricing skills within the Defense Department and advises the director on issues relating to contract costs, pricing, and finance.

He is accompanied by Mr. David McDermott, the director of Standards, Compliance, Defense Finance, and Accounting Service. Mr. Dermott is responsible for developing finance and accounting goals and standards and analyzing operational results. Mr. George is going to provide testimony on behalf of the Defense Department and answer questions related to those issues. Mr. McDermott will not be testifying but is also available to answer questions as well, especially regarding the Defense accounting system. Gentlemen, thank you.

We will go ahead and recognize Mr. Loftis for his comments.

STATEMENT OF CURTIS M. LOFTIS, JR.

Mr. LOFTIS. Thank you, sir. Mr. Chairman, members of the Committee, I am honored to be here today.

Mr. Chairman and members of the Committee, I am very honored to be here today. I urge the repeal of the federal 3 percent withholding provision. Section 511 imposes an arduous and costly mandate. It will unfairly penalize state and local governments and businesses that run honest, taxpaying companies. The impact and unintended consequences of this requirement on both government and private enterprise are serious. Expensive implementation costs come during a time of a weak financial recovery. Compliance with this recovery will prove oppressive, deprive entries, and will definitely cost us jobs. Of course, the taxpayer will have to pay the burden of this plan.

I am the Treasurer of South Carolina, but I am also a small businessman. I have three dozen employees in Columbia, so I have to take these issues seriously. I would like to share with you how I see the impact of all of this. First, let us look at the negative impacts on the state and local governments. The provision imposes administrative costs and recording requirements for implementation and maintenance of the vendor tax withholding and the actual payment of the tax on behalf of the vendors to the IRS. It will be an administrative nightmare. There will be major modifications to accounting systems and other administrative processes. The manpower and dollar costs of the provisions for the local and state government access across the country will be astronomical. Coupled with administrative costs, many believe the vendors will increase their prices to government in order to compensate for this penalty tax. Again, as a result the taxpayers will pay more.

The withholding law will negatively affect governments' budgets at a time when every dollar counts. Smaller units of governments may not be able to sustain the burden of administering this program. Federal tax enforcement is the function of the IRS and the federal government, not of the state and local governments. The 3 percent withholding penalizes all tax-compliant businesses. It forces them to provide the federal government with an interest-free loan by requiring advanced payment on taxes which may not even be due at the end of the year. The withholding is based on gross revenues from contract payments and they may have no relationship to taxable income. Firms with tight profit margins will lose funds necessary for vital operations. Cash flow may be damaged to the point that some companies withdraw from doing business with the government altogether. Business expansion could be halted or deferred. Additional cash flow constraints can push some companies out of business altogether.

I am particularly concerned about what Section 511 does to my home state. Small business is essential to the well-being of South Carolina. In 2008, there were 364,000 small businesses in South Carolina, and they account for 50 percent of the private sector jobs. Small firms made up 97 percent of South Carolina employers. Small business is the engine that drives South Carolina's economy. The success of the small business sector is critical to our economic

recovery. The withholding requirement will reduce the amount of capital available for payroll, new business investment, and daily expenses. South Carolina's unemployment rate in April placed us at the ninth highest in the country.

Mr. Chairman, we need jobs, not more regulation. We need capital, not more taxes. There is a saying, "an error we refuse to correct has many lives." I believe the negative consequences of this mandate will snowball, so I strongly urge the members of this Committee and the House to take action as quickly as possible to repeal Section 511. I would like to commend Representative Herger for his work on H.R. 674, and also Mr. Chairman, I would like to give a special thank you to my fellow South Carolinian for allowing me to come and speak to you on behalf of the state and local governments in South Carolina.

[The statement of Mr. Loftis follows:]

Chairman MULVANEY. Thank you, Mr. Loftis. I appreciate that very much.

Mr. George, if you will go ahead and give your testimony, then we will ask questions of the panel as a group.

STATEMENT OF BRIAN GEORGE

Mr. GEORGE. Chairman Mulvaney, Congresswoman Chu, and distinguished members of the Subcommittee on Contracting and Work Force. I welcome the opportunity to appear before you today to discuss the Department's Report to Congress.

Our 2008 report addressed the impacts of compliance with Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. My name is Brian George, and I serve as the Deputy Director in the Office of Cost, Pricing and Finance for the Defense Department. My organization prepared the 2008 report.

With me today is Mr. David McDermott, the Director for Standards and Compliance at the Defense Finance and Accounting Service. He is responsible for overseeing the Comptroller's implementation of Section 511. Our report was submitted in response to the House's Committee and Armed Services' request that the Department assess the impact of compliance with Section 511. As you are well aware, Section 511 requires federal, state, and local governments to withhold and remit to the IRS 3 percent of payments made to contractors for goods and services. At the time the report was prepared, the IRS had not developed regulations to implement the Section 511 withholds. As a result, our report was based on a number of assumptions regarding how the IRS would implement the withholds.

We originally estimated for implementation and then management for the first five years, \$17 billion to comply with Section 511. This included about \$4 billion related to the Department losing the use of the commercial purchase card and about \$13 billion related to contractors' costs. The Department still expects the impact to comply with Section 511 to be in the billions of dollars but lower than the original estimate. It will be lower since a few of our assumptions in 2008 differed from the final IRS regulations published this month. Let me discuss just two of those assumptions.

We correctly assumed the IRS would not allow companies to offset the amounts withheld under Section 511 against their esti-

mated quarterly income or payroll tax payments. The report expressed our concern that contractors properly paying their tax obligations will experience cash shortages equal to the amounts withheld until the amounts are recovered through the normal federal income tax process. However, we incorrectly assumed that the IRS would not exclude third-party payments, such as the commercial purchase card, from the 3 percent withhold. Our report stated that if third-party payments were not excluded, DOD would lose its ability to use the commercial purchase card. This would occur because the Department would not be able to execute withholds against those payments. Almost \$8 billion of our estimate related to that impact. However, in its final rule, the IRS indicated that it may require withholding of such transactions in the future.

Although the costs for DOD and our contractors to implement Section 511 will be less than we estimated three years ago, we still expect the impact to be significant. The Department is concerned that Section 511 will restrict the available cash of tax-compliant companies, especially small businesses and we are also concerned the Department may lose its use of the commercial purchase card in the future.

This concludes my verbal statement. Mr. McDermott, I will be happy to address your questions and request that my written statement be entered into the record.

[The statement of Mr. George follows:]

Chairman MULVANEY. Thank you, gentlemen. And for all of the witnesses, your witness statements have already been entered into the record.

Very quick question. You hit on something, Mr. George, that caught my attention, which is the \$17 billion was roughly broken into two pots—\$4 billion for this purchase card but \$13 billion for increased contractor costs. Tell me a little bit more about that. How did you all arrive at the number? What is driving that number?

Mr. GEORGE. I will be glad to tell you about that.

Of the \$13 billion for the contractor, about \$4 billion related to the purchase card, \$9 billion related to implementation costs and re-incurring costs to implement this rule.

Chairman MULVANEY. So to implement this particular regulation would cost just the Department of Defense—not the whole federal government, just the Department of Defense—\$9 billion?

Mr. GEORGE. Well, the \$9 billion—

Chairman MULVANEY. Million or billion, sir?

Mr. GEORGE. Billion.

Chairman MULVANEY. Okay.

Mr. GEORGE. Of the \$9 billion, most of that is contractors' cost.

Chairman MULVANEY. For them to implement it?

Mr. GEORGE. That is correct.

Chairman MULVANEY. Which is then passed on to us through higher costs.

Mr. GEORGE. It could be passed on to us. That is correct.

Chairman MULVANEY. Exactly. Thank you, Mr. George.

Mr. Loftis, do we—very briefly, do we withhold in the state of South Carolina in a system similar to that? Do we withhold for taxes?

Mr. LOFTIS. No, sir. We have a limited program for out-of-state contractors who do work with the state but it is a state tax. Nothing for the federal government.

Chairman MULVANEY. So you would have to completely overhaul your entire accounting system at the state, local, and county level in order to implement this regulation.

Mr. LOFTIS. That is right. There are multiple agencies now, like the Department of Revenue, the Treasurer's Office, Comptroller General, and others, the Budget Office, who are working on this all without any certainty of where the program is going. So it equates to a lot of wasted man-hours so far.

Chairman MULVANEY. I recognize Ms. Chu for as much time as she needs.

Ms. CHU. Mr. George, we have talked about the implementation costs for the DOD. Are you aware of any other agencies that have conducted similar studies that analyze their costs in complying with the 3 percent law?

Mr. GEORGE. No, ma'am. I am not familiar with any other agencies.

Ms. CHU. DOD, of course, is so large. Would you anticipate that it might cost even more for smaller agencies to implement such a withholding?

Mr. McDERMOTT. I would be reluctant to answer for any other agencies, Congresswoman Chu.

Ms. CHU. Well, then, Mr. McDermott, let me ask. The original intent of the 3 percent withholding was to stop tax cheats. It is a laudable goal because there are many tax-compliant businesses that are competing with these tax-avoiding businesses. However, the 3 percent withholding provision will make honest taxpayers face these enormous burdens under this law. As the Director on Standards and Compliance, what other less burdensome methods are available to the federal government to ensure that government contractors are also good taxpayers?

Mr. McDERMOTT. Congresswoman Chu, I can speak to what we do today to ensure that we are working with companies that are not delinquent on their taxes. In the beginning of the contracting process, the contracting officers do check to see with the Contractor Registration System to see if a contractor has been disbarred or for some reason has some delinquency or other reason that they would not do work with the government. For the agency that I work with, we participate in a program called the Treasury Offset Program, where we trade information with the Department of the Treasury, approximately 13,000 payments a day that we share information with the Treasury on that the Treasury looks to see if there are any delinquencies either for taxes or other government debts. And if there is such a debt, we offset the amount up to the amount of the payment that we are looking at at that particular time. During fiscal year 2010, we were able to liquidate 3,500—approximately 3,500 debts. That is our main way of ensuring that we assist the rest of our government partners in liquidating debts to include tax debts.

Ms. CHU. How do you assess the success of this?

Mr. McDERMOTT. We believe that it is a successful program by virtue of the fact that we did find approximately 3,500 debts work-

ing with the Treasury, and those were funds that were recouped to the government that did not go to the contractor where we would have to go after them after we had made that payment.

Ms. CHU. Mr. George or Mr. McDermott, small businesses provide the federal government with goods and services in a wide range of services. Examples include construction contracts, retail, and information technology services. From the DOD's perspective, are there any industries that would be disproportionately affected by the 3 percent withholding requirement?

Mr. GEORGE. Ma'am, not from my perspective. I think small businesses would be hurt perhaps harder. And that is speculation on my part. And let me just go back to the other question you asked Mr. McDermott. One thing that has happened on the contracting side since this law is passed is that contractors have to certify that they are not tax delinquent to get a government contract. So that is a significant step they have to go through now to get a contract. It did not happen before.

Ms. CHU. Yes, Mr. McDermott.

Mr. MCDERMOTT. Congresswoman Chu, our applicability of this would be across every organization that we do business with so I cannot say that any one particular business would be disproportionately affected just by the withholding. Obviously, other things that you have discussed about small businesses and the impact it may have on that.

Ms. CHU. Mr. George, the SBA estimates that nearly 75 percent of all small firms will fail within the first five years, while existing firms may be able to absorb a 3 percent withholding, newly formed firms are often the most cash strapped. At a time when we should be promoting economic development, has your office done any assessment on the impact that the 3 percent requirement would have on start-up companies?

Mr. GEORGE. We have not done that, but one thing we have tried to do for small businesses, is we just implemented a new rule where we can accelerate payments to small businesses. So we are aware it is important to increase their cash flow, so we are trying to do that as a Department.

Ms. CHU. Thank you. I yield back.

Chairman MULVANEY. Thank you. I recognize the gentleman from Florida, Mr. West, for five minutes.

Mr. WEST. Thank you, Mr. Chairman. My question is for you, Mr. George and Mr. McDermott.

A couple of weeks ago I had a really good conversation with a dear friend of mine, Colonel Pete Newell, who is the head of the Rapid Equipping Force for the United States Army. Are you familiar with the Rapid Equipping Force mission?

Mr. MCDERMOTT. I am not.

Mr. GEORGE. Not personally.

Mr. WEST. Okay. The Rapid Equipping Force for the United States Army, what they do is they go out into the combat theaters of operation and they give recommendations from the soldiers that are on the ground and then they come back here to look for small businesses that can provide these requirements to these emerging technologies that they do not have to go through an entire long-drawn-out procurement process. You know, my concern when I look

at this, and I would like to get your estimate, do you think that this 3 percent withholding provision would incentivize a lot of small businesses to go into contracts that can enable us to provide, you know, rapid technologies to our soldiers that are on the combat theaters of operation right now?

Mr. GEORGE. Incentivize or decentivize?

Mr. WEST. Well, do you think that as it is right now this provision, will it incentivize people to go into, you know, contracts with the United States Army to provide these emerging technologies for our soldiers in the field?

Mr. GEORGE. I would speculate it would not incentivize them at all.

Mr. WEST. Thank you very much. I yield back.

Chairman MULVANEY. Thank you. At this time I would like to recognize the gentleman from Oregon, Mr. Schrader, for five minutes.

Mr. SCHRADER. Thank you, Mr. Chairman.

Since you are resident government experts, I will ask a couple questions. And if you are unable to answer them I would understand.

The bill as originally conceived talked about some exceptions. Do you all know the exceptions to the 3 percent withholding?

Mr. GEORGE. Off the top of my head, no.

Mr. SCHRADER. All right. Given the fact, and you alluded to it a moment ago in your testimony, Mr. George, that there have been some improvements and changes in how we are addressing some of the delinquencies that have occurred. Could you elaborate a little bit on some of the others that are out there that have occurred since this bill was put in play and how that has hopefully, possibly affected your ability to collect money you would otherwise not have been able to collect from contractors?

Mr. GEORGE. Well, I would say there are two. One is on the contracting side and one is on the Comptroller side as we mentioned. One is, again, very significant. They have to register if they have \$3,000 or more in delinquent taxes before they get a contract. The contracting officer has to look at that, and if it is actually affirmative, they have to investigate that and may even refer that to the Debarment Official if there is an affirmative response. On the Comptroller's side, Mr. McDermott mentioned about the offset program as well. So those two things I think have been, at the prime contract level, very successful.

Mr. SCHRADER. Are you able to quantify how much improvement you have gotten and DOD, you know, how your collections have improved quantitatively as a result of those types of improvements?

Mr. MCDERMOTT. Congressman Schrader, for fiscal year 2010, because of the Treasury Offset Program, we were able to collect on approximately 3,500 instances of debt. I do not have the dollar amount to be able to quantify that. But prior to the Treasury Offset program we were not sharing that type of information so that would have been information we would not have had to offset those payments.

Mr. SCHRADER. So that is good news. Without having to burden small businesses you are making progress with some of the newer regulations. Is it not also true that the acquisition forms and proc-

esses would have to be changed at some cost to the federal government as a result of this law if it gets implemented?

Mr. GEORGE. On the acquisition side we would have to make some changes to our systems and also on the Comptroller side. And we would have to implement regulations to make sure we collect the 3 percent withhold. That is correct.

Mr. SCHRADER. So to reiterate a point that I think is being made here, we are only seeing the tip of the iceberg in terms of increased cost to government contractors and small businesses as a result of this 3 percent withholding?

Mr. GEORGE. There is definitely an increased cost. That is correct.

Mr. SCHRADER. I guess I will yield back, Mr. Chair. Thank you. Chairman MULVANEY. Thank you, Mr. Schrader.

I recognize the gentle lady from North Carolina, Ms. Ellmers, for up to five minutes.

Ms. ELLMERS. Thank you so much, Mr. Chairman.

My questions are going to be directed to each one of you. You know, the cost of doing business in this country is extravagant and we are losing jobs and we are not creating jobs because of it. Mr. Loftis, in your opinion, does this 3 percent withholding increase jobs or decrease jobs?

Mr. LOFTIS. Decreases jobs most decidedly.

Ms. ELLMERS. Mr. McDermott?

Mr. MCDERMOTT. That would be out of my area of expertise, Congresswoman Ellmers, to answer.

Ms. ELLMERS. Well, from a common sense standpoint, if the cost of doing business is increased for any small business company, contractor, does not that really equal the loss of jobs? That is one less job for every regulation. Every tax that you have to adhere to, that could possibly be a job that you are not creating. Would you not agree?

Mr. MCDERMOTT. Congresswoman Ellmers, I cannot disagree with you but I would not be able to base that on our estimates or what we are doing to implement this law. But I cannot disagree with you.

Ms. ELLMERS. So let me ask you this then. From a small business perspective, contractor perspective, do you believe, do you agree that the cost will have to increase for consumers? That the cost of doing business will go up because of this 3 percent increase?

Mr. MCDERMOTT. Again, Congresswoman Ellmers, I cannot say for sure. I am sure there are a number of different ways that a business person would look at this to try and compensate for it to ensure that they have appropriate cash flow and to compensate for their profit margins.

Ms. ELLMERS. Do you believe the revenue that has been found or the tax advantage that you had mentioned that there were some tax revenues that were found because of this, do you think that that fully offsets the cost to our consumers?

Mr. MCDERMOTT. I do not have the exact dollar amount of what we collected but I am quite positive that it would be less than what we are estimating it would cost to implement this.

Ms. ELLMERS. That it would be actually less? The money that is actually generated for the government in tax revenue is actually less than the cost to the business owner?

Mr. MCDERMOTT. From the Treasury Offset program, yes.

Ms. ELLMERS. Okay. Mr. George, could you—

Mr. GEORGE. Let me answer that from a personal perspective. I think when you mention it will increase costs, I think it will increase costs. At one time I was on the board of a small, not-for-profit small business. It was a school, on the Board of Directors, and cash flow was incredibly important. And this will affect their cash flow. And if you do not have cash, you cannot pay employees. And that actually happened to us a few times. So I understand the impact to small businesses.

Ms. ELLMERS. Yeah, you know, I mean, we are seeing this over and over again. I had the opportunity back home last week when we were in our district sitting down with small business owners, some of them contractors, and the cost of doing business is so high that they cannot create jobs. There are so many issues. Regulation taxation is what is harming all of our businesses and that is why we are not creating jobs in this country. You know, the private sector is where these jobs are created and until we deal with these issues, we are going to continue to see this. We can turn this around. It is just going to take a matter of all of us putting our heads together.

Thank you. With that, Mr. Chairman, I yield back.

Chairman MULVANEY. Thank you, Ms. Ellmers.

I have one or two brief follow-up questions for Mr. Loftis. Mr. Loftis, you mentioned in your testimony that—I think you said you are already starting to try to implement this. Is that correct?

Mr. LOFTIS. Well, we have to study it. You know, the deadlines keep being pushed back, so the CG's Office has spent a significant amount of time. The Department of Revenue, I mean, all of these offices, we study and then it gets put off. And then we study it and it gets put off. We have to devote valuable man-time to it. The computer resources devoted to it and the changes needed are going to be particularly expensive. We have just gone to a new statewide accounting program, which of course will have to be altered.

Chairman MULVANEY. And is that replicated at the counties and the town levels as well?

Mr. LOFTIS. Counties and towns will have a very difficult time. You know, I think the threshold that you could drop below that you do not have to mind this regulation is \$100 million. But for counties that have hospitals or school districts, that is not very hard to get through at all. And they are just not equipped. Treasurers' offices in some of the counties may be two people.

Chairman MULVANEY. You know, we talk oftentimes up here about the importance of making permanent changes as opposed to continually making temporary changes. In your mind is there a difference between a one or two year extension and just a complete removal of this requirement?

Mr. LOFTIS. The complete removal would be great. The uncertainty breeds just that, uncertainty, and that costs us money.

Chairman MULVANEY. And how many contracts approximately is the state of South Carolina going to be impacted in?

Mr. LOFTIS. Well, it is funny you ask that because I tried to find that out. And we do not know because the contractor process is so old it has never been brought on computers like it should be. So this is one of the problems. So when we started investigating whether or not we will have to have arbitration contracts that were multi-year extend into this period, we just do not know.

Chairman MULVANEY. Is there any reason to think it is going to be better in any of the other states?

Mr. LOFTIS. I cannot imagine, no. We are relatively small. I would think it would be awful in a state like California or Texas or New York.

Chairman MULVANEY. I cannot imagine the headaches they would have.

Gentlemen, thank you very much. I really appreciate your time. Does anyone have any follow-up questions? Thank you again.

At this time I would like to seat our third panel. The final panel is made up of three small business witnesses and a government contracts expert.

The first witness is Mr. Mike Murphy, president of Murphy Turner Company, Inc., a third-generation, family-owned general contractor specializing in water and waste water treatment plants. He is also from Rock Hill, South Carolina. Mr. Murphy is testifying on behalf of the Associated General Contractors of America. I am especially pleased to welcome Mr. Murphy as he is one of my constituents.

We also have with us Mr. Ian Frost, a principal at EEE Consulting in Mechanicsville, Virginia. He is testifying on behalf of the American Council of Engineering Companies. Mr. Frost, welcome as well.

And we have Mr. James Gaffney, vice president of Goshen Mechanical in Malvern, Pennsylvania, testifying on behalf of Quality Construction Alliance.

And we also have an additional witness who will be introduced by the ranking member, Ms. Chu.

Ms. CHU. Thank you, Mr. Chair.

It is my pleasure to introduce Kara Sacilotto, who is a partner with the law firm Wiley Rein Law Firm and is an expert in federal procurement law and policy. She has extensive experience in litigation matters relating to government contracts, including bid protests, claims litigation, prime subcontractor disputes, and trade secret misappropriation litigation. She regularly counsels government contractors regarding compliance matters and has conducted numerous internal investigations of alleged misconduct by government contractors. Ms. Sacilotto is also an adjunct faculty member at George Mason Law School. Thank you for being here today, Ms. Sacilotto.

Chairman MULVANEY. Thank you, Ms. Chu. And welcome, Ms. Sacilotto as well.

We will begin with Mr. Murphy. Mr. Murphy.

STATEMENT OF MIKE MURPHY

Mr. MURPHY. Thank you. Thank you, Chairman Mulvaney and Ranking Member Chu for the opportunity to testify on the 3 percent withholding law. I am testifying on behalf of the Associated

General Contractors of America, a national Trade Association representing more than 32,000 companies, including 7,000 of America's leading general contractors and 11,000 specialty contractors.

My name is Mike Murphy. I am president of Turner Murphy Company. My dad, Turner Murphy, started our company in 1950. We are a third-generation construction company based in Rock Hill, South Carolina. Today we work primarily on wastewater and water treatment plants construction ranging in size from \$100,000 to \$25 million. We employ seven full-time employees in the office and 20 to 40 in the field depending on how much work we have. However, I believe Congress is making it tougher and tougher for my company to stay in business by not repealing a requirement that will make federal, state, and local governments withhold 3 percent from each and every payment to contractors for goods and services.

This withholding applies to the total contract, not to the taxable net revenue generated from a project. This provision has nothing to do with my company's tax liability. It is just an accounting gimmick that whitewashes over the real costs of government while leaving small companies like mine holding the bag.

This 3 percent holding is more than the profit margin on most public construction contracts for companies like mine. The average take-home after taxes for construction is 3.2 percent, and for smaller construction companies, 25 million and under, the margin is closer to 1.6 percent. So the 3 percent withholding is almost 200 percent of the total profit for small companies.

Local, state, and federal governments already hold five to 10 percent on our payments until project completion. Retainage is different than this withholding requirement in that it is tied directly to the project and is released when the project is completed. The 3 percent withholding is not tied to the project nor based on any project performance criteria. It is not released when the project is completed. It is held for as much as a year or more. It is just an interest-free loan to the federal government.

This withholding also affects critical parts of my business such as cash flow and bonding capacity. When the public owner I am working for withholds 3 percent from each and every payment it causes my company to finance more of the work on the project without being paid for it. This ripples down to my suppliers, sub-contractors, and service providers. Some suppliers ask for payment upfront, which means I am paying for things before even being reimbursed by the government entity. The additional 3 percent withholding will make this process even worse, which could possibly hamper the ability of some general contractors to pay their sub-contractors in a timely manner.

This reduced cash flow would also restrict bonding capacity which is a key to my company being able to bid on projects. Federal law requires that construction contractors carry several types of bonds. Surety companies who provide the bonds study my books in detail before offering coverage. Based on past performance on contracts, the suitability of my company to perform the work for which I bid, my assets, and my cash flow, surety gives Turner Murphy Company a bond rating which governs the price of the bonds and

how much bonded coverage I can receive. My ability to get bonding directly impacts how much work my company can take on.

Implementation of this law could not come at a worse time for my company and my industry. The construction industry went into a recession a year and a half before the overall economy and still has not emerged from it. The industry has lost nearly a third of its workers and nearly a third of the construction put in place since 2006. The tough economic conditions have made competition on public jobs fierce and profit margins tight. We are seeing more and more bidders on a dwindling number of projects. This causes many companies to shave more and more out of profit margins in hope of actually getting the job.

What is truly frustrating for us is that there are already policies in place that prevent the kind of tax behavior this law is designed to stop. Instead of punishing all contractors, the federal government should enforce the laws already on the books. Existing laws require all corporations to make quarterly estimated tax payments to cover income tax liabilities. These laws should be vigorously enforced, and on public projects all of our jobs are bonded. Having bonds on projects ensures the taxpayers that the jobs will be completed at no additional cost to the public.

This new 3 percent withholding law is just another layer of red tape that creates serious cash flow problems for government contractors in perhaps the worst industry conditions in modern times. It does not help solve a problem by using solutions that are already on the books. It is just a bad public policy. Three percent withholding on government contracts will seriously impact my business and the businesses of the construction industry at large. The vast majority of the members of the contracting community are responsible taxpayers. Do not punish the whole industry because of a few bad apples.

Again, thank you for the opportunity to testify on behalf of ADC, and I appreciate the fact that three members of the Subcommittee and six members of the Full Committee have co-sponsored this legislation. I look forward to any questions that you may have that will help get the rest of you to co-sponsor H.R. 674.

[The statement of Mr. Murphy follows:]

Chairman MULVANEY. Thank you, Mr. Murphy. I appreciate that.

Mr. Frost, you are recognized for up to five minutes.

STATEMENT OF IAN FROST

Mr. FROST. Chairman Mulvaney, Ranking Member Chu, and members of the Committee. I appreciate the opportunity to testify today on the three percent withholding mandate, and particularly its impact on small firms that contract with federal, state, and local entities of government.

My name is Ian Frost and I am the president of EEE Consulting. We are a small engineering firm based in Richmond, Virginia. I am here to ask for your assistance in repealing the three percent withholding rule.

As you know, in 2006, Congress included a provision in the Conference Report for the Tax Increase Prevention and Reconciliation Act that requires federal, state, and local governments that spend

more than \$100 million a year on goods and services to withhold three percent from payments to engineering firms and other contractors. I am also a member of the American Council of Engineering Companies, ACEC, the voice of America's engineering industry. ACEC firms number more than 5,000, over 70 percent of which are small firms. Most have government clients, and like EEE Consulting, would be negatively affected by the three percent withholding mandate.

EEE Consulting has been in business since 1998 and has grown to a 36-person firm with revenues of about \$4.3 million last year. About 95 percent of our work is for local, state, and federal agencies. During one of the most difficult economic periods that we have lived through, we have experienced steady growth. Since the recession started, we have actually added 13 new employees, five of whom were unemployed. We also signed an agreement to build a new office just as the recession hit. Despite a lot of trepidation over the economic forecast, we stayed the course on the new building and moved in during the spring of 2010. Our success could not have occurred without an unencumbered cash flow. We have relied upon the personal finances of our owners and the company's cash reserves to buy new equipment, to pay the salaries of new employees until we get paid by our clients, and to pay for expansion of the company, including the new construction.

To a small business, cash flow is everything. I am immensely proud of our past record, yet concerned about the future because the pending three percent withholding rule would negatively affect our cash flow and our potential to grow and add new jobs. If enacted right now, the rule would mean the withholding of approximately \$130,000 of our projected 2011 revenue and it might require our company to secure a loan to help us cover operating expenses at a time when cash in the bank is limited. The withholding could limit our ability to make payroll each month, our ability to expand our business, and hire new employees. A \$130,000 withholding each year would deplete our cash reserves by about 30 percent.

Our situation is not unique. Our trade association, ACEC, has raised serious concerns over how this mandate will impact engineering firms, including thousands of small firms like mine that work for government. Many engineering companies realize a profit margin of just about three to five percent on a contract, and withholding three percent up front for tax purposes will force them to divert funds needed to complete the contract, thereby creating cash flow problems. Three percent withholding will also burden small firms with additional administrative and recordkeeping costs. Firms like mine will have to modify their accounting systems in order to keep track of the withholding and ensure that it matches with their tax records and tax refunds.

I frequently hear in the news that small businesses are the economic engine for the country and are likely to be the main source of job creation that is needed to reduce our unemployment rate. Why then would the federal government want to handcuff that economic engine by withholding a percentage of our contracts, hurting our cash flow, and limiting our ability to add new jobs?

I know that the withholding rule is intended to help with tax collections, but it seems unreasonable to punish everyone involved in

government contracting due to the actions of just a few. The only solution to this problem is to repeal the three percent withholding mandate and replace it with measures that target firms and individuals that are not in compliance with the tax laws.

I have attached to my testimony a list compiled by the Government Withholding Relief Coalition of tax compliance measures that have been enacted since the three percent withholding provision was passed in 2006. For example, in 2008, the Federal Acquisition Regulation was amended to require potential federal contractors to certify that they are in compliance with their federal tax obligations. This provision makes noncompliance with the tax code grounds for suspension and debarment from government contracting. Measures such as this focus on the problem instead of impacting firms that pay their taxes.

As an owner of a small business, I ask you to help give us relief from the unfair withholding rule. Please find alternatives that ensure that the government receives its share of our revenue without damaging our ability to operate, add new jobs, and meet our payroll.

Thank you for the opportunity to participate in today's hearing, and I would be happy to respond to any questions.

[The statement of Mr. Frost follows:]

Chairman MULVANEY Thank you, Mr. Frost. And as I mentioned, we will take questions for the whole panel after the testimony is finished.

Mr. Gaffney, you are recognized for up to five minutes.

STATEMENT OF JAMES M. GAFFNEY

Mr. GAFFNEY. Good morning, Chairman Mulvaney and members of the House Small Business Committee, Subcommittee on Contracting, On Contracting and Work Force. Thank you, Chairman Mulvaney, for holding this important hearing today and for inviting me and my association to participate.

My name is Jim Gaffney, and I am the principal owner of a small business mechanical construction firm, Goshen Mechanical Contractors, located in Malvern, Pennsylvania. My firm operates in the public sector construction markets throughout the greater Philadelphia area, in the Delaware Valley, and throughout Southeastern Pennsylvania. Our firm performs many public sector construction projects in which I am prime and subcontractor, such as public school new construction and retrofits and other municipal facilities, both as a prime and as the sub, with a variety of public sector entities that will be covered by the 3 percent withholding tax unfunded mandate if it is not repealed before it takes effect January 1, 2013.

I am here today representing the Mechanical Contractors Association of America. MCAA is a nationwide specialty construction employer trade association based in Rockville, Maryland. MCAA's member companies perform all types of mechanical, plumbing, heating and ventilation, new construction and maintenance, and service work for public project owners nationwide. The vast majority of MCAA members' companies are small businesses and many of them perform projects of the type that will be covered by the 3 percent withholding unfunded mandate.

I am also president of the Mechanical Contractors Association of Eastern Pennsylvania, which is based on the Philadelphia area and which counts a majority of small business contractors among its 100 members. Many of those firms, too, perform projects for government entities that will be covered by the 3 percent withholding mandate. I am also privileged to represent four other of our sister associations in an ongoing legislative quality construction alliance. These groups are the Sheet Metal and Air Conditioning Contractors National Association, the International Council of Employees of Bricklayers and Allied Craft Workers, the Finishing Contractors Association, and the Association of Union Constructors. According to the Bureau of Labor statistic figures, specialty construction employers present the vast majority of industry employment and over 64 percent of the employment overall in the industry. The majority of the QCA association member companies, too, are small businesses and they, too, perform a great deal of public work projects with the governmental entities that will be covered by the 3 percent withholding mandate if it should go forward in 2013.

I should add that many of the QCA groups also actively participate in a wider government withholding relief coalition, which also adamantly espouses rapid repeal of the 3 percent withholding provision in Section 511 of the Tax Reconciliation Act of 2005 and the QCA fully supports that coalition's written remarks filed on the record for this hearing.

My business is the American dream. I started my business 25 years ago in the basement of my mother and father's home. We worked in the field by day and we bid at night and on the weekends. The only real downtime that I had was on Sundays for mass and breakfast with my wife and four children. Today we have over 20 employees and have work on hand of over \$8 million.

The tax, quite honestly, will put me out of business. Last week I bid a project in a school district in Lower Merion outside of Philadelphia where I took the job for four percent just to keep the cash flow rolling. I lost the job by 3 percent. With retainage being held on these projects at 10 percent plus 3 percent, small business will be replaced by large brokers that will end up causing the end-user more money. Not only will the overall costs go up, but trust me, the quality of work will go down. As a prime contractor, I will not be able to hold the 3 percent on my subs. As a subcontractor, the prime will incorporate some kind of language to exclude the 3 percent from my invoices.

I have been in business for over 25 years. I pay my taxes every year and on time. It is very easy to determine what my taxes are by the billing systems that are used on our projects. For each project I must submit a detailed breakdown for the project before it starts—labor, material, equipment, everything. Soup to nuts. Once it is approved, I bill percentages each month for that work that was performed. Each month a CM, project manager, or owner's representative requires a walk-through to visually confirm all the work that I have on my invoice has been completed.

Once my financial statements are updated—and they are done every three to six months because the bonding company in this economy is on our backs every day—these projects are listed showing the percentages that are completed and our taxes are based on

that information. And with the restrictions and the quality background checks that are done in the state of Pennsylvania on a lot of the local state's and school district work, they actually require me to submit my financial statement before the project is bid. They make me have my accountant notarize that financial statement and sign a letter of non-collusion.

I hear from many economists that in these challenging times most people do not get it on how bad the economy is until the bomb goes off. I see a lit fuse with this tax. Between the extra costs needed for my office staff to track the tax withholdings and the extra work needed from my accountant, I am looking at at least a 24 percent increase in my costs for recordings.

Thank you for your time.

[The statement of Mr. Gaffney follows:]

Chairman MULVANEY. Thank you, Mr. Gaffney.

Ms. Sacilotto, thank you for waiting. You are recognized for up to five minutes.

STATEMENT OF KARA M. SACILOTTO

Ms. SACILOTTO. Thank you, Chairman Mulvaney, Ranking Member Chu, and members of the Subcommittee for the invitation to participate in today's hearing.

You have heard firsthand from others regarding the economic impact of the 3 percent withholding on businesses and the enormous administrative costs the law will impose on federal, state, and local governments. I share those concerns but my testimony today focuses on a different aspect of the problem, the disruptive and costly impact of the withholding requirement on the federal procurement system, impacts that will likely be experienced by state and local governments as well. My testimony today is mine alone and does not represent the views of my firm or any of its clients.

Today I address three impacts and why I believe government has the tools available already to target delinquent taxpaying contractors, making implementation of an across-the-board withholding that bears no rational relationship to past or future tax liability unnecessary. First, the 3 percent withholding undercuts federal policies and programs intended to assist small businesses in contracting with the federal government. These policies and programs which I describe in my written testimony are designed to ease the cash flow burdens on small businesses, remove barriers to entry, and otherwise promote small business participation in federal contracting. The 3 percent withholding requirement, however, directly undermines these policies by destabilizing cash flows. It will disproportionately harm small businesses and likely deter the innovative small businesses government is trying to attract from entering the federal marketplace at all.

Second, the 3 percent withholding will discourage commercial item contractors from selling their products to government. Congress has enacted laws to encourage vendors of commercial items to sell their products to government so that government can take advantage of innovative, commercially available products, as well as commercial pricing. Over the past decade, however, as the pendulum of regulation has swung back in favor of oversight, commercial item contractors have found themselves subject to more and

more of the regulations that apply to their noncommercial counterparts but that have no equivalent in the commercial marketplace. The 3 percent withholding and the costs of complying with and administering it are yet another added cost of doing business with the government. Given a choice of customers, it is entirely reasonable to believe that vendors of commercial items will decline to incur this additional cost. Government will then face reduced competition for acquisitions of commercial items, diminished access to innovative commercial products, and more than likely increased costs because the costs of dealing with the government no longer reflect the costs of the commercial marketplace.

Third, there will likely be increased disputes between contractors and the government. Determining whether a contract has been materially modified such that the withholding would apply to contracts entered into prior to December 31, 2012, or if as the IRS proposes the government can apply the withholding to payments under any contract after January 2014, regardless whether the underlying contract includes provisions that permit such a withholding, are just two areas where disputes will arise. Acquisition regulations provide that if government wishes to add a new requirement or clause to an existing contract or make some other change that increases the contractors' costs, the contractor is entitled to compensation for the cost of the change. Thus, in addition to disputes that will likely arise when parties attempt to true up the withholdings, disputes will arise whether the government is even entitled to include the withholding requirement in the first instance and the cost for doing so.

There are likely many more negative impacts on the procurement system that will surface if this provision is allowed to take effect. If there is good news to this story it would be that there are existing enforcement tools that make imposing this costly and burdensome requirement unnecessary.

You have heard today about the IRS Federal Levy program that targets tax debt. This current law now permits the IRS to levy or offset up to 100 percent of any specified payment due to a vendor of goods or services sold or leased to the federal government. You have also heard that current regulations require contracting officers to determine whether a contractor is responsible prior to the award of any federal contract. To assist with this responsibility determination, acquisition regulations were amended in 2008 to require contractors submitting proposals to certify whether they have tax debt over \$3,000. Contractors also are now required to report in a database largely available to the public but fully available to contracting officers civil administrative or criminal findings of liability or penalties over \$5,000. Acquisition regulations were further amended to permit the government to suspend or debar a contractor from contracting with the government entirely for being delinquent in federal taxes. In 2010, the White House instructed the IRS and OMB to review the certifications and report whether delinquent contractors were receiving contract awards.

In closing, I do not wish to diminish the seriousness of a failure to pay taxes but note that the system has mechanisms in place that can target delinquent taxpayers without harming taxpaying contractors. Given these existing mechanisms, the perceived bene-

fits of the 3 percent withholding are vastly outweighed by the burdens and costs the withholding will oppose.

Thank you again for this opportunity to share my views, and I am happy to address any questions you may have.

[The statement of Ms. Sacilotto follows:]

Chairman MULVANEY. Thank you, Ms. Sacilotto.

I have a few questions for the panel. First to Mr. Murphy. Mr. Murphy, one of the things we have heard regularly today is that one of the fears here is that contractors will simply add this additional 3 percent to their bids and as a result prices will go up for everybody, including the taxpayer. But I understand from your testimony—I think you mentioned it briefly—it is actually worse than that. In your industry you cannot do that. Is that right?

Mr. MURPHY. That is correct.

Chairman MULVANEY. Tell me why that is.

Mr. MURPHY. Our margins are so tight now there is always somebody that is willing to take the job cheaper, as Mr. Gaffney said, for one percent. And normally that added cost you would pass on but in this industry and the market we are in now you just cannot do it. It is just something else we are going to have to absorb. Another brick we are going to have to put in our load.

Chairman MULVANEY. You and Mr. Gaffney both mentioned the concept of retainage, which I am familiar with but I am not sure everybody else here is. When you—tell us a little bit about how that works, how retainage works generally.

Mr. MURPHY. Okay. We have a contract with an entity, let us say Rock Hill. Say \$5 million. The first pay request we send in is, say, for \$100,000. Well, they pay us \$90,000 of that \$100,000. They hold the other 10 percent until the project is complete and you have passed certain milestones. So over the course of that project it will go—whatever the progress payments are, by the end of the project they have got a half million dollars of your money.

Chairman MULVANEY. But you can get that money upon completion?

Mr. MURPHY. Right. It is up to us. When we finish, the sooner we finish, the sooner we get the money. With this money, we are up to—we are leaving it up to our good friends here in Washington to decide when and how we are going to get it.

Chairman MULVANEY. And that is what I think a lot of people do not understand about the proposals is that retainage, which everyone in the industry is familiar with, you get when the project is finished. This 3 percent withholding is different. You do not get this 3 percent withholding back until you pay your taxes for the year in which the project finished. So you could finish a project in January of 2012 and not actually get your money until April 15th of 2013. So it is not retainage, although I have heard a lot of people say this is similar to retainage. It is just another 3 percent retainage. And it is actually much worse than that.

We have asked a couple of folks—I will ask Mr. Frost and Mr. Gaffney and Ms. Sacilotto as well because I think you mentioned the legalities of this—why is another short-term extension not a solution? And I put that to anyone who wants to speak to it.

Mr. GAFFNEY. For me personally, the problem I have is we just cannot afford—if I am bidding a project that is going on for two

years or three years and this could be implemented in the middle of the project, we are having to walk away from it. So I am not bidding the work today for any of the long-term projects just because of the fear that this could come into play in the backend of the project, in the last year of the project. We just cannot afford it. I just could not do that. So that is why it is impacting us today.

Chairman MULVANEY. Ms. Sacilotto.

Ms. SACILOTTO. Sure. Well, contracts every day are being entered into and some of those contracts are long-term contracts. They are not going—they are not just for the next couple of years. They are for the next five, seven, 10 years. And there are no provisions in the Federal Acquisition Regulation now that implement this 3 percent withholding. Yet, there are plenty of provisions that require the government to pay its bills on time and pay them in full. So we have a lot of instability in the market right now as contractors are trying to figure out, well, how am I going to deal with this. And contracting officers do not really have the tools necessary. As we can see, people are still trying to figure out how to implement this. So as contracts are being entered into now there is a great deal of uncertainty. Having instability in any market is obviously not a positive thing.

Mr. FROST. And let me add to that, if I may. You mentioned that if it was delayed would that be helpful. And of course there would be some advantage there but you heard the gentleman from the Department of Defense speak to the fact that they are already planning for that and incurring costs associated with that planning, as is industry. And so if we are incurring costs when the ultimate outcome is going to hopefully be repeal of that mandate, then why not repeal it now?

Chairman MULVANEY. And I think Mr. Loftis said the same thing. The states are doing the same thing in anticipation of it.

Mr. FROST. Exactly.

Chairman MULVANEY. Mr. Murphy, you had an addition?

Mr. MURPHY. To me, putting it off another day does not help because it is still a bad policy. It is not going to be any better a year from now, or two years from now, or three years from now.

Chairman MULVANEY. Mr. Murphy, you mentioned one thing—and this will be my final question—that caught my attention. You mentioned that the average margin to a contractor of your size, 3.2 percent I think you mentioned. And then you mentioned that for a lot of the subs who are smaller than you it was down as low as 1.6 percent. And I think that drove home for me how dramatic the impact—while the impact of this bill would be felt industry-wide, the smaller the business the more dramatic it would be. How would your subs be able to operate under this system?

Mr. MURPHY. Like Mr. Gaffney said, some of these you would not be able to pass it on to them. They would just go out of business because a lot of these guys that we deal with, concrete finishers and some mason stuff, you have to pay them every week. You hold 3 percent for a year on them, they would just go out of business. Or they would quit doing work with you.

Chairman MULVANEY. Thank you very much. I will recognize Ms. Chu for as much time as she would like.

Ms. CHU. Thank you.

I wanted to follow up on several of the issues you raised. Ms. Sacilotto. Ms. Sacilotto, one of the central themes of your testimony was that the 3 percent withholding rule undermines other government initiatives established to promote economic growth for small firms. Can you explain how those traditionally disadvantaged firms, such as minority-owned or women-owned firms would be impacted?

Ms. SACILOTTO. Sure. I can give you—well, if a company cannot raise money to operate its business, obviously any policy that we put into effect, just at a broad level, is not going to be effective because it will be driven from the market. But a specific policy that is put into effect in the Federal Acquisition Regulation and even more so by DOD is to give small businesses a greater percentage of their progress payments. So a traditional large business, the default is 80 percent of your costs. Small businesses, depending on whether it is with a civilian agency or DOD, can get up to 95 percent of their progress payments. And there is also, you heard mentioned, a DOD policy that was recently enacted to accelerate payments to small businesses. Well, shaving off 3 percent is obviously directly undermining those policies that are meant to assist small business with contracting with the government. It undermines—the notion that you will get paid faster yet you will get paid less is not exactly equal.

Ms. CHU. You also raised the issue pertaining to Federal Acquisition Regulation—complex federal contracting regulations already serve as a huge barrier to small firms seeking government work. Can you elaborate on how federal acquisition regulations would be modified if the 3 percent withholding became effective and what this would mean for small businesses in the contracting arena?

Ms. SACILOTTO. Honestly, I think that the repercussions are going to be enormous. And I have not studied this but I have been thinking about recently the Prompt Payment Act. The Prompt Payment Act is a government law that was enacted because the federal government did not have rules about when it paid its invoices. So sometimes it was paying too late and incurring interest, and sometimes it was paying too early and losing the time value of its money. So the Prompt Payment Act has rules about when you pay your invoices. And if you do not pay your invoices on time, the contractor is entitled to interest. If the government pays early, there are certain clauses that are in the FAR, which is the Federal Acquisition Regulation, that allow the government to get a discount for paying early.

It seems to me that the entire prompt payment system is going to be—is completely broken. If the government can essentially not pay promptly 3 percent of the payments that are owed, are they going to incur interest on that because they are not paying it promptly? And the idea of this was the government was realizing it was losing a vast amount of money—the time value of money by paying too early. Well, contractors are now losing that time value of money by paying their taxes early. So should the government get a discount for paying early when it is withholding 3 percent of the money? This is just one tiny little aspect of the contract process that I think will be affected by this 3 percent withholding. This applies to small businesses, large businesses, all businesses. And con-

tracting officers and our acquisition workforce who are stretched thin already are going to have to try to figure out how to deal with this.

Ms. CHU. And my final question has to do with those commercial item vendors, those small businesses that offer all kinds of items, including high tech products that would be available on the commercial market. In your testimony you mentioned that 3 percent withholding would disproportionately dissuade commercial item contractors. What is unique about this industry that would create this situation?

Ms. SACILOTTO. Well, when you think about a commercial item contractor you are thinking about somebody who—a company that's business is not tailored to, you know, perhaps building a bomb or something that is specific to the federal government. It is providing perhaps IT services and cloud computing and things that I do not even know about because they are so high tech and innovative. Well, they can sell their products out on the free market to companies, to businesses, to anybody. They do not have to necessarily—they are not beholden to the federal government for this. It is a great market to enter into but is it such a great market to enter into when I have this 3 percent withholding and every other cost of doing business? As a small innovative business, if I have options, this will definitely make me consider whether or not it is worth it to come into the federal marketplace.

Ms. CHU. Thank you. I yield back.

Chairman MULVANEY. I recognize the gentle lady from North Carolina, Ms. Ellmers, for up to five minutes.

Ms. ELLMERS. Thank you, Mr. Chairman.

Ms. Sacilotto, my question for you is you had outlined that there are already provisions in place that should be dealing with these issues as far as, you know, the revenue coming in, the tax burden, that we may be lost. Is that correct that you feel they are already in place?

Ms. SACILOTTO. Yes.

Ms. ELLMERS. And yet they are not being adhered to?

Ms. SACILOTTO. Well, that I do not know from an IRS perspective whether or not they are being adhered to. I believe that a number of laws have been passed recently to allow the IRS to withhold more and more money. I would say that the recent GAO report that came out that the chairman mentioned, there were 15 cases of delinquent taxpayers that were, I guess, emphasized in that report. The IRS has gone after all 15 of them so I cannot say that it is not working.

Ms. ELLMERS. Well, based on the information that we have and considering that there are things that are already in place, why do you, you know, it seems to me the impetus for this is to find this money, this 3 percent withholding in order to help pay for that or to find that or to locate those monies that might not be coming in and, you know, pretty much put that burden on all of our good tax-paying citizens because of those few that do not. If, in fact, those things that are already in place really do not seem to be working, why would this work? In your opinion, what would make this the golden egg of finding tax revenue?

Ms. SACILOTTO. Well, I do not think this is the golden egg of finding tax revenue. And like I said, I cannot say that those measures are not working. Some of the evidence suggests that they really are. And to go back to this GAO report, I would say that this—that report—it is unfortunate that there are contractors who do not pay their taxes. Nobody is going to defend that. But if you read the report, it was only five percent of the contracts that were actually examined.

Forty-five percent of the taxes at issue that they found owing were excise—I am sorry, payroll taxes. They were non-income taxes. So will this help that? No. It will not get that entire 45 percent of the problem that was identified. Also, half of the delinquent taxpayers were subrecipients and I think in my mind I think of a subrecipient as a subcontractor. Well, subcontractors are not subject to the withholding. It applies to the prime contractor.

Ms. ELLMERS. To the prime contractor.

Ms. SACILOTTO. Right. So that is under the IRS rule. So you are not getting all of those people. So, right there that is not getting all of the problems. There was an addition. Oh, and then the fact that the IRS is actually—it is taking enforcement actions against all 15 of the cases that it said were known really bad actors. Well, that to me suggests that the system is not broken. That we need to just focus on using the tools that we have available already rather than adding an additional tool.

Ms. ELLMERS. Thank you.

Mr. Gaffney, if I am not mistaken I believe you had said that if this were to be put in place today it would cost you about 24 percent more to do business.

Mr. GAFFNEY. Correct.

Ms. ELLMERS. And you would literally have to close your doors. Is that correct?

Mr. GAFFNEY. When I say that I know it sounds like it is dramatic.

Ms. ELLMERS. No, no. It is not.

Mr. GAFFNEY. It is the truth. In our business, you know, my mother is in the office, my sisters are in the office. When the girls are doing the accounting everyday downstairs we would actually have to come down, track down all our vendors which on a given project could be in the hundreds, make sure that the 3 percent is held from the vendor, from the subcontractor, from another material supplier, and so forth and so on. And 24 percent is probably a low number but I wanted to be conservative. And it will put us out for the reason that there is no money to the developers today. So in the Philadelphia area and the surrounding areas in Pennsylvania, there is no money for the developers. There is no cash flow out there. So a lot of the smaller businesses tend to go into the work that is either government at the state, local, whatever the case may be. With this 3 percent that goes in there, we just cannot do it. We cannot do it.

For the most part, right now small businesses in my area are taking jobs for just about nothing, just to keep the money coming in so the bonding company is happy and the banks are happy for the line of credit. If it was not for that, we would be gone. With

that 3 percent being held for whatever the period of time is, it is coming. It is just a matter of time.

Ms. ELLMERS. Thank you. Mr. Chairman, can I have one more minute for—I would like to ask Mr. Frost and Mr. Murphy—

Chairman MULVANEY. With no objection you are recognized for an additional minute.

Ms. ELLMERS. Okay. Mr. Frost and Mr. Murphy, I just wanted to ask both of you, you know, as business owners, I believe, Mr. Murphy, you had said that basically this would—for your projected income of 2011 or your projected project it would cost you about \$100,000. Is that—

Mr. MURPHY. Well—

Ms. ELLMERS. I am sorry, Mr. Frost, you had said—

Mr. FROST. We would lose about \$130,000 of revenue if it was in today's dollars.

Ms. ELLMERS. Simply just to adhere to this?

Mr. FROST. Yes.

Ms. ELLMERS. In your opinion, how many jobs would—if you know that that is a cost that you are not going to have to incur, can you create—would you be able to go out today and hire someone else to work under you?

Mr. FROST. It would be extremely difficult. As I said, our history has been that we have been hiring people and we have been able to do that because our cash flow has allowed us to. We would have to take loans if we were going to hire additional people to cover their payroll until we got paid by the federal government or the federal, state, and local governments.

Ms. ELLMERS. Sure. And Mr. Murphy, if you could answer that as well.

Mr. MURPHY. I agree with Mr. Frost and I will make one comment about cash flow. A guy told me this a long time ago. It is not air but it is pretty close to it. So it is that important.

Ms. ELLMERS. Well, absolutely. And you know, again, and in your opinion for both of you, you know, if we just—if we just put this off for a few months or a year you are still going to be in the same situation because you are still going to be faced with that uncertainty. Correct?

Mr. MURPHY. The uncertainty of it and the inevitability of it if it happens. I mean, it is not like it is going to be easier to take a year from now.

Ms. ELLMERS. Right. Thank you so much for your testimony. I really—it has been invaluable to this situation. Thank you.

Mr. MURPHY. Thank you.

Chairman MULVANEY. Thank you, Ms. Ellmers. And that provides a good closing for the whole meeting. Thank you for everybody who came. Thanks especially to the folks who came from out-of-town. I appreciate you incurring the time and the expense to do that. I do not think that folks who come to testify often recognize how important these hearings are and how valuable they can be to shed light on issues that ordinarily would not see the light of day. This is not an issue that makes the front page of the Wall Street Journal or the New York Times, but this is an absolutely critical issue for your economy, for our small businesses, and as you can tell, for state and local government, the Department of Defense.

This is an important issue and the fact that you were able to come today, give us your testimony in writing, have a chance to give us your oral testimony and then take questions is extraordinarily helpful to us as we try and push this bill through on what appears is going to be to all aspects a bipartisan basis. So I really appreciate—the anecdotes especially help us explain to our colleagues exactly how important this is, how powerful a change this would be if we do not fix it, so I appreciate everyone's time.

With that I would ask unanimous consent that we have five legislative days to submit statements and supporting materials for the record. And without objection, thank you all to everybody who came. And that will conclude this meeting.

[Whereupon, at 11:35 a.m., the subcommittee was adjourned.]

CERTIFICATE OF NOTARY PUBLIC
DISTRICT OF COLUMBIA

I, Christine Allen, notary public in and for the District of Columbia, do hereby certify that the foregoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Notary Public, in and for the District of Columbia
My Commission Expires: January 14, 2013

Statement of Rep. Wally Herger (CA-2)

**Hearing on the Need to Repeal the 3% Withholding
Provision**

**House Committee on Small Business
Subcommittee on Contracting and Workforce**

May 26,2011

Chairman Mulvaney, Ranking Member Chu, and Members of the Subcommittee – Thank you for holding this hearing on the need to repeal the 3% withholding tax on government contracts. As someone who has been passionately opposed to this tax from the day it was first signed into law, I am encouraged by the Committee’s interest in this issue.

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 requires government agencies at all levels – federal, state, and local – to withhold 3 percent of payments for goods and services, effective in 2012. The Internal Revenue Service has recently issued regulations delaying this requirement until January 1, 2013, but agencies and businesses must still plan for it to eventually take effect. The breadth of this 3% withholding tax is truly astounding. It affects everyone from the manufacturer who builds tanks for the Army to the nursing home that cares for poor seniors on Medicaid, from the

construction workers who repair roads and levees to the commissaries that sell groceries to families on military bases.

As the members of this Subcommittee are well aware, small businesses are the lifeblood of our economy. I come from a small business background myself, so I have firsthand knowledge of how our country's entrepreneurs and job creators are burdened by a complex tax code and cumbersome regulations. If the 3% withholding tax is permitted to go into effect, it will only add to that burden. Many businesses that contract with the government operate on very narrow profit margins – often less than 3 percent. As a result, this tax will create serious cash flow problems for small businesses.

Today, our economy is in poor condition. The stock market may have improved from the low point of the recession, but for most Americans, the signs of recovery have been few and far between. Millions of people are still without work. In my northern California congressional district, some counties have more than 20% unemployment. Government regulations and taxes that were a bad idea even in happier times, are absolutely disastrous when our economy is struggling to recover and create jobs.

In addition to its impact on small businesses, the recession has also taken a toll on state and local government finances. Cities, counties, and states across America are struggling to balance the

budget without raising taxes or slashing vital services. The 3% withholding tax would worsen this fiscal crisis by creating new administrative costs and potentially raising procurement costs for state and local governments.

Supporters of the 3% withholding requirement have billed it as a tax compliance measure. Yes, it's a problem when government contractors don't pay their taxes. But instead of slapping a new tax on everyone – a tax that will actually cost the government more to collect than it raises in revenue – we could simply stop awarding government contracts to people who cheat on their taxes. In fact, since the 3% withholding provision became law, OMB and the Treasury Department have announced several initiatives to do just that. Hopefully these new compliance measures will provide the final push for Congress to repeal 3% withholding once and for all.

Again, I appreciate the opportunity to testify this morning, and I look forward to working with the Chairman and other members of this committee to move ahead with repeal.

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BY THE COMMITTEE

WRITTEN STATEMENT OF
MR. BRIAN GEORGE
DEPUTY DIRECTOR, OFFICE OF COST, PRICING AND FINANCE
DEFENSE PROCUREMENT AND ACQUISITION POLICY
BEFORE
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES
ON
IMPACT OF COMPLIANCE AT
THE DEPARTMENT OF DEFENSE WITH
SECTION 511 OF THE TAX INCREASE AND RECONCILIATION ACT OF 2005

MAY 26, 2011

FOR OFFICIAL USE
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BY THE COMMITTEE

Chairman Mulvaney, Congresswoman Chu and distinguished members of the Subcommittee on Contracting and Workforce, I welcome the opportunity to appear before you to discuss questions regarding the Department of Defense's (DoD's) report to Congress. Our 2008 report addressed the impacts of compliance with Section 511 of the Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005. Section 511 generally requires the Government to withhold and remit to the Internal Revenue Service (IRS) three percent of payments made to its contractors.

My name is Brian George and I serve as the Deputy Director, in the Office of Contract Cost, Pricing, and Finance. My Office's mission is to help ensure that the taxpayer and Warfighter obtain contracted goods and services at fair and reasonable prices. We are the focal point for the Department's pricing and finance polices on our contracts with industry.

I report to the Director of Defense Procurement and Acquisition Policy (DPAP), Mr. Shay Assad. DPAP is responsible for all acquisition and procurement policy matters in DoD. The DPAP office also serves as the principal advisor to the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L), Dr. Ashton Carter, on procurement strategies for the acquisition of all major weapon systems and services.

With me today is Mr. David McDermott, the Director for Standards and Compliance at the Defense Finance and Accounting Service, an organization reporting directly to the Under Secretary of Defense (Comptroller). He is responsible for developing finance and accounting goals and standards and analyzing operational results

for the Department. He also is responsible for overseeing the Comptroller's implementation of Section 511 and will be answering any questions related to how the Comptroller is implementing this rule.

Department of Defense's Report – Background

Our March 2008 report was submitted in response to the House of Representatives' Report of the Committee on Armed Services that accompanied the National Defense Authorization Act for Fiscal Year 2008 (H.R. 110-146). The Committee's report requested the Department to assess the impacts of compliance with Section 511 of TIPRA (Public Law 109-222). Section 511 generally requires federal, state, and local governments to withhold and remit to the IRS three percent of payments made to contractors or other entities for goods and services. The law was to be effective January 1, 2012 though the final IRS implementing regulation delays the start of withholding until January 1, 2013.

The Department's March 2008 report was prepared by my organization with significant inputs from an industry association and from staff in the Under Secretary for Defense, Comptroller's office. It addressed the cost of modifications to our financial accounting systems, additional personnel costs, and anticipated financial impacts for defense contractors.

At the time the 2008 report was submitted to Congress, the IRS was developing implementing regulations to establish the process for the Section 511 withholds. Accordingly, our report was based on a number of assumptions regarding how the IRS

would implement Section 511 and included a caveat that the estimated impact would be more accurately known when the IRS published its final implementing regulations.

About eight months after we issued our report, the IRS published its December 2008 proposed regulation for the three percent withholding under section 3402(t) of the Internal Revenue Code. And early this month, on May 9, 2011, the IRS published its final regulation in the Federal Register. Since some provisions in the final IRS regulation differ from a few key assumptions we used to estimate the impact of the three percent withhold, I will address the changes that would have to be made as I next discuss the details of our 2008 estimate.

Report - Cost Impact, Key Assumptions and Concerns:

As detailed in our 2008 report, we estimated that the cost would be significant for the Department and its contractors to comply with Section 511. Specifically, to comply with TIPRA, we estimated \$17.6 billion for implementation and management for the first five years¹, comprised roughly as follows:

- \$4.2 billion related to the cost to DoD to implement withholding related to the (loss of use of the) commercial purchase card;
- \$50 million for DoD implementation and recurring costs other than the purchase card impact;
- \$6.3 billion related to contractor implementation costs; and finally,

¹ The report included the (nonrecurring) cost to implement Section 511 (years 2009 to 2011), which totaled \$6.3 billion. It also included the annual recurring cost to manage it for the first five years (2011 to 2015) which totaled \$11.3 billion (assuming an effective implementation date of January 2011).

- \$7.1 billion for contractor recurring costs.

The Department still expects the impact to comply with TIPRA to be in the billions of dollars, albeit lower than the \$17 billion we originally estimated. It will be lower since a few of our key assumptions in 2008 differ from the IRS final regulations published in 2011. Following are some of the assumptions we made to develop our 2008 estimate:

First, we assumed the IRS would establish a process for the Section 511 withholds similar to the process the IRS established for backup withholding (under 26 U.S.C. 3406(b)). Consistent with our assumption, the final regulation requires the Department to withhold three percent of the affected payments, remit the withheld money to the IRS, and report the amount of payments and associated withholds to both the IRS and the payees. Additionally, payees are required to recover excess withholds through the normal federal income tax process, not DoD.

Second, we assumed the IRS would not allow payees to offset the amounts withheld under Section 511 immediately against estimated quarterly income or payroll tax obligations, which is consistent with the final IRS regulation.² The Department's 2008 report expressed our concern that companies properly paying their tax obligations will experience cash shortages equal to the amounts withheld until the amounts are recovered through the normal federal income tax process. That concern remains unchanged, particularly for small businesses.

² The final IRS regulation does not permit a credit against estimated income taxes for the specific quarter in which the amount is withheld, but allows for such a credit in the taxable year for which the taxpayer would receive credit for the withholding.

Third, we assumed the IRS would not apply the withholding requirements to prime contractors' payments to their subcontractors, which is also consistent with the final rule.

Fourth, we incorrectly assumed that the IRS would not exclude third party payments, such as the commercial purchase card, from the three percent withhold. Our 2008 report stated that, if third party payments were not excluded, DoD would lose its ability to use the commercial purchase card and other third party payment mechanisms. This would occur because the Department would not be able to execute the Section 511 withholds against those payments. Almost \$8 billion of our 2008 estimate related to this impact; \$4.2 billion for DoD and about \$3.6 billion for our contractors.

Although the final regulation excludes purchase card payments from the withholding requirements and related reporting requirements, the IRS indicated in its final rule that it may require withholding on payment card transactions (including payments by credit, debit, and other payment cards) in the future. If the IRS elects to impose the withholding and reporting requirements on purchase card payments at a later date, the Department will incur significant additional costs as stated in our 2008 report.

Fifth and finally, the final regulation states that withholding will not apply to any payment less than \$10,000 (although this limit is subject to an "abuse" rule). By contrast, our 2008 report assumed the three percent withhold would apply to *all* payments, regardless of amount. Although we have not revised our 2008 cost estimate to reflect this change, the \$10,000 threshold will help reduce the impact, especially on the small business

community.

The Department continues to be concerned that the three percent withhold will limit the number of companies willing to enter into the government market, thereby reducing competition and access to new technologies. In addition, we believe that the final IRS rule will be difficult to implement and administer, especially since Agencies are liable for any amount they fail to withhold.³

Conclusion

Although the cost for the Department and our contractors to implement TIPRA will likely be less than originally estimated in 2008, we still expect the impact to be in the billions of dollars. I am particularly concerned that it will restrict the available cash of tax-compliant companies, especially for small businesses, which would otherwise be used to develop new technologies and provide working capital. I appreciate the work the Subcommittee is doing to assess the impact of TIPRA and thank you for the opportunity today, to discuss the Department's 2008 report.

³ However, the liability will be abated if the Agency can demonstrate that the contractor has included the amount of the payment in income and paid the appropriate taxes, typically through a signed statement of the contractor.

**Testimony by
The Honorable Curtis M. Loftis, Jr.
State Treasurer
South Carolina Office of State Treasurer
P. O. Box 11778
Columbia, SC 29211**

**House Committee on Small Business
Subcommittee on Contracting and Workforce
Defer No More: The Need to Repeal the 3% Withholding Provision
May 26, 2011, 10:00 A.M.
Room 2360, Rayburn House Office Building
Washington, DC**

Position:

Support full repeal of Section 511, 3 percent withholding on government contracts.

Comments:

Mr. Chairman and members of the Committee, I am honored to be here today. Thank you for the opportunity to testify on this very important matter.

I am here to urge you to repeal the federal 3% withholding provision, Section 511, which imposes a burdensome and costly mandate that will affect government contracts at all levels of government. Additionally, it will negatively affect businesses throughout the country. While the 3% withholding requirement was designed to increase tax compliance, it will unfairly penalize state and local governments and small businesses that run honest taxpaying companies. The IRS tax collection responsibility is being handed off to state and local governmental agencies and tax compliant businesses through this mandate.

The impact and unintended consequences of this withholding requirement on both governments and companies are detrimental. Excessive implementation costs come at a time when the public sector is trying to recover from economic havoc. Additionally, compliance with this requirement will prove financially oppressive to private industry and will cost jobs.

And, who will ultimately bear the cost of this new requirement? The taxpayer. The taxpayer will absorb the costs!

While I serve as the State Treasurer of South Carolina, I am also a small business owner. I would like to share with you how I see this law impacting both government and business.

Impact on Governments:

First, let's look at the negative effects on state and local governments.

The provision imposes administrative costs and information reporting requirements for implementation and maintenance of (1) the vendor tax withholding requirement, and (2) remission of the tax on behalf of the vendors to the Internal Revenue Service. In South Carolina, these responsibilities would be handled by the Comptroller General's Office.

In addition to these costs, the requirement presents an administrative nightmare. Modifications to accounting systems and other administrative processes will have to be resolved. Add up the manpower and dollar costs of the withholding provision for all of the local and state governments across the county and you will find the amount is astronomical.

Coupled with administrative costs, many believe that vendors may be inclined to increase their prices to governmental entities to compensate for this penalty tax in order to minimize their revenue losses. Some, if not all of the costs, may be passed on to governments through higher contractor bids. As a result, taxpayers will be forced to pay more.

The withholding law will negatively affect government budgets at a time when every dollar counts as we're all trying to recover from the great recession. Public budgets are already severely strained and budget woes continue to persist in many states and at all levels of government. Lower levels of government especially may not be able to sustain the burden of altering accounting systems and providing other services necessary to administer the program.

Federal tax compliance enforcement is the function of the IRS, not of state and local governments. This withholding provision would place an unfair burden on state and local governments during a time when they're already facing serious budget challenges.

Impact on S. C. and U. S. Businesses:

The withholding requirement is equally harmful financially to our country's businesses.

The 3% withholding requirement unjustifiably penalizes all tax compliant businesses. It forces businesses to provide the federal government with an interest-free loan by requiring advance payment of taxes that may not be due at the end of the year.

The provision will seriously affect businesses' cash flow, which has already been severely impacted by the economic downturn. The withholding is based on gross revenues from contract payments and has no relationship to businesses' taxable income. Businesses with tight profit margins will lose vital funds necessary for operations, and as a result, will be forced to pass the added costs on to their government customers. Cash flow may even be damaged to the point that some businesses withdraw from doing business with government altogether. Any business

expansion could be halted or deferred. Additional cash flow constraints could push some companies out of business completely.

The provision adds yet another layer of tax withholding and reporting requirements for both governmental entities and U. S. businesses.

Of course I am particularly concerned about what Section 511 will do to small businesses in South Carolina. Small business is essential to the financial well-being of South Carolina. In 2008, there were nearly 364,000 small businesses in my state. More than 81,000 of them were employers, accounting for nearly 50% of private-sector jobs. Small firms made up 97 percent of South Carolina's employers.

The withholding provision will gravely affect South Carolina small business cash flow. As companies lose essential funds needed for day-to-day operations, they will be forced to pass along the added cost of the Section 511 mandate to customers. Contractors operating on slim profit margins will pass along the cost to their subcontractors.

Small business is the engine that drives South Carolina's economy. The success of the small business sector is critical to my state's economic recovery. The withholding requirement will throw a ratchet into companies' operations by reducing the amount of money available for payroll, new business investment, and daily expenses. It will stifle small business expansion as well as new business upstarts.

The continued success of existing small business, along with new business enterprise, is key to South Carolina's ability to increase its gross state product, state personal income, and total employment. I am confident that the same is true for all of the other states. So, why hamper with economic performance by imposing this expensive and unwieldy withholding requirement? It's an unnecessary and costly interference with the vitality of small business.

The bottom line is that the 3% withholding mandate will be detrimental to the job market. South Carolina's unemployment rate in April was 9.8% (unadjusted), the ninth highest in the country. Marion County continued to have the highest jobless rate at 18.7%. It should be noted that these rates do not include those individuals who have stopped looking for jobs or those who have collected maximum benefits. Nor is it indicative of those who are underemployed. We simply cannot take a hit on employment in South Carolina.

There's a saying "an error we refuse to correct has many lives." I believe the negative consequences of this mandate will snowball. You have the opportunity to make it right by repealing it.

In summary, let's not block the progress of our state and local governments and our businesses by allowing this costly and burdensome legislation to take effect. The timing is especially critical as state and local governments and businesses throughout the country are struggling to recover from the worst economic slump in decades. At a time in our country's history when job creation is critically important to economic recovery, let's not allow this obstruction to impede progress. I ask for your help in repealing this withholding provision.

For the good of our state and local governments, private businesses, and individual taxpayers, I sincerely hope legislation repealing this withholding requirement becomes law and that it becomes law expeditiously before more money is spent preparing for its implementation. Time is of the essence as governments are entering into multi-year contracts now that may include increases due to the withholding provision.

I strongly urge the members of this Committee and the House to take action as quickly as possible to repeal Section 511.

In closing, I would like to commend Representative Herger for his work on H.R.674 which will repeal this onerous requirement, and Chairman Mulvaney for holding today's hearing on this issue.

Again, I appreciate the opportunity to testify before you today. I will be happy to answer any questions.

Statement of
Mr. Mike Murphy of Turner Murphy Company, Inc.
on behalf of
The Associated General Contractors of America
to the
Subcommittee on Contracting and Workforce
Committee on Small Business
U.S. House of Representatives
For a hearing on
“Defer No More: The Need to Repeal the 3% Withholding Provision”

May 26, 2011



Building Your Quality of Life

The Associated General Contractors of America (AGC) is the largest and oldest national construction trade association in the United States. AGC represents more than 33,000 firms, including 7,000 of America's leading general contractors, and over 12,000 specialty-contracting firms. Over 13,000 service providers and suppliers are associated with AGC through a nationwide network of chapters. AGC contractors are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects, site preparation/utilities installation for housing development, and more.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
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Statement of Mr. Mike Murphy
Turner Murphy Company, Inc., Rock Hill, South Carolina
Subcommittee on Contracting and Workforce
Committee on Small Business
United States House of Representatives
May 26, 2011

Thank you Chairman Mulvaney and Ranking Member Chu for this opportunity to testify on the three percent withholding law. I am testifying on behalf of the Associated General Contractors of America (AGC), a national trade association representing more than 32,000 companies, including 7,000 of America's leading general contractors and 11,000 specialty contractors. AGC is the voice of the construction industry.

My name is Mike Murphy, President of Turner Murphy Company Inc, and a member of the Carolinas AGC, an AGC chapter covering North and South Carolina. My dad, Turner, started our company in 1950, with assets of \$127.42. We are a third generation construction company based in Rock Hill, SC. Today, Turner Murphy Construction works primarily on wastewater construction. We have successfully completed over 125 major treatment plants and upgrades. We self perform an average of 80% of all work in place. Our project range is from \$100,000 to \$25,000,000. We employ seven full time employees in the office, and 20-40 in the field, depending on how much work we have.

However, I believe Congress is making it tougher and tougher for my company to stay in business by not repealing a requirement that will make federal, state, and local governments withhold 3% from each and every payment to contractors for goods and services. This withholding applies to the total contract, not to the taxable net revenue generated from a project. This provision has nothing to do with my company's tax liability, it is just an accounting gimmick that whitewashes over the real cost of government while leaving small companies like mine holding the bag.

This 3% withholding is more than the profit margin on most public construction contracts for companies like mine. The 2010 Construction Industry Annual Financial Survey, conducted by the Construction Financial Management Association, included responses from 623 companies. Earnings after taxes in the most recent fiscal year averaged 3.2%, up from 3.0% in 2009. For smaller construction firms, \$25 million and under, the margin is closer to 1.6%. So the 3% withholding is almost 200% of the total profit for small companies.

So if my company is lucky enough to win a public contract to build a wastewater facility and my total bid price is \$1,000,000 here is simplified example of how the money would break down if I applied this 1.6% average profit. I would spend \$984,000 for materials, labor, and subcontractors. My company's profit would be \$16,000 on the project. If my company paid a 35% federal tax rate, my company's tax liability would be \$5,600. The 3% withholding law would force the government to withhold \$30,000 from payments to my company for the work performed. That is more than 5 times the tax

liability my company could owe on the project. It is also almost two times my total profit on the project. Can you imagine how you would feel if you got your pay stub and instead of a withholding that closely matched your tax owed they withheld five times your tax liability or they figured out a way to withhold two times what you actually made. This withholding provision is an interest free loan of \$24,400 from my company to the federal government. Imagine what that would do to your ability to pay your bills, take out loans or take care of long term commitments. It has the same impact on my company.

Local, State, and Federal governments already hold 5-10% retainage on our payments until project completion. Another 3% is unduly burdensome. Retainage is different than this withholding requirement in that it is directly related to the performance of the contract: meeting certain milestones, paying subcontractors and suppliers and finishing with high quality. In short, making sure the government gets a good product in the end. According to Businessdictionary.com, Retainage is the "Portion of a contract's final payment withheld by a principal (client or owner) until the project is complete in all respects, functioning satisfactorily according to the contract terms, and all mechanic's liens have either been released or have expired." It is tied directly to the project and released when the project is completed. The 3% withholding is not tied to the project nor based on any project performance criteria. It is not released when the project is completed, it is held for as much as a year. It is just an interest-free loan to the federal government.

The law will reduce my company's cash flow and reduce my company's ability to compete for business. When the public owner I'm working for withholds three percent from each and every payment, it causes my company to finance more of the work on the project without being paid for it. Under the regulations this money can be refunded when I file my annual tax return. That means I could be out this money for a year or more. This ripples down to my suppliers, subcontractors and service providers. Some suppliers ask for payment up front, which means I am paying for things before being reimbursed by the government. The additional 3% withholding will make this process even worse, which could possibly hamper the ability of some general contractors to pay their subcontractors in a timely manner. Subcontractors, often also small businesses, also have a tight cash flow and need to be paid on time; this could hurt many companies and make it difficult for them to stay in business.

This reduced cash flow would also restrict bonding capacity which is the key to my company being able to bid on projects. Federal law requires that construction contractors carry several types of bonds. Surety companies, who provide the bonds, study my books in detail before offering coverage. Based on past performance on contracts, the suitability of my company to perform the work for which I bid, my assets and my cash flow, a surety gives Turner Murphy Company a bond rating which governs the price of the bonds, and how much bonded coverage I can receive.

For example, a surety might offer coverage for \$10 million worth of work, at a cost of 1%. If a surety thought I was a risk because my cash flow had been restricted by this new 3% withholding, it may only cover \$5 million for 3%. That coverage governs the

size of contracts I can bid on, as the maximum amount I can have under contract at any one time would be either \$10 million, or \$5 million. My ability to get bonding, which again depends on a number of factors including my cash flow, directly impacts how much work my company can take on. This withholding law will reduce cash flow, leading to higher costs for bonds and borrowing for public contractors. It could also lead to the denial of coverage. The 3% withholding law imposes all of these negative constraints on businesses working for the public entities. It can't help but drive contractors out of public construction and drive up the cost of construction for the taxpayers.

And the implementation of this law couldn't come at a worse time for my company and my industry. The construction industry (residential plus nonresidential) went into recession a year and a half before the overall economy and still has not emerged from it. The total value of construction put in place was \$1.2 trillion in 2006. That number shrunk to about \$800 billion in 2010. That loss of \$400 billion in projects has led to loss of many good jobs and many good companies. The industry has lost 2.25 million jobs, nearly a third of its workers, from its employment peak in April 2006. The industry's unemployment rate in April 2011 was 17.8%, not seasonally adjusted, the highest of any industry and more than double the all-industry rate.

The tough economic conditions have made competition on public jobs fierce and profit margins tight. We are seeing more and more bidders on a dwindling number of projects. This causes many companies to shave more and more out of profit margins in hope of actually getting the job. A recent survey of AGC contractors found that in 2011, 29% of them planned to adjust their bids so that profits were smaller. And 3% planned to adjust bids so that they would be for a loss. Even when your company is losing money on a project, the 3% withholding law requires the withholding of 3% of every payment to a contractor.

This tough competition also means that any argument that contractors could cope with this law by simply increasing their bid prices is ludicrous. In this kind of market there is always someone willing to do the job. Someone will suffer through the situation instead just to keep money coming in the door, just to keep making payments on equipment and just to keep good people earning a paycheck. Recent history proves this. Right after September 11th, insurance costs skyrocketed, contractors didn't increase costs overall, because there was always someone who wouldn't raise their prices, in hopes of out-bidding the competition.

A tough economy magnifies the impact of preparation costs we are now having to factor into bids. Construction companies, as well as federal, state and local governments are expending funds preparing for implementation now. The Tax Withholding Relief Coalition estimates that the total costs to federal, state, and local governments, as well as to private industry, will exceed \$20 billion. That far exceeds the estimated increase in tax revenues generated by the provision. Much of these costs are needless preparation expenses, particularly during the current rough economic times. And, with companies facing narrower profit margins, due to stressed economic conditions leading to increased bidders for every contract, the prospect of additional tax withholding diverts

cash away from business expansion activities, including workforce investment and equipment purchases. This provision is a drag on many segments of the economy.

These implementation burdens are particularly acute on S Corporations and Joint Ventures. Sixty percent of businesses in the construction industry are S Corporations, including mine, meaning the corporate income tax is paid at the shareholder level. Family-owned businesses often have many shareholders, especially as families grow and expand. All shareholders pay the business' income tax on their personal taxes, and then would be required to keep track of this 3% withholding through the year for tax purposes. They and their accountants will be using their great record-keeping systems in order to ensure funds are not lost along the way or over-counted. So I thank this Committee for recognizing the particular burden this law will place on small businesses.

Withholding creates additional reporting burdens on other pass-through 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. As government construction contracts have grown, expanded, and become more complicated, construction companies have had to increasingly work together to tackle large projects. Joint ventures, which are created to complete only one large project, such as the Woodrow Wilson Bridge, do not 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. The law could drive joint ventures out of the market, leaving large federal construction jobs with very few, if any, bidders.

What is truly frustrating for us is that there are already policies in place that prevent contractors from the kind of tax behavior this law is designed to stop. Instead of punishing all contractors, the federal government should enforce the laws already on the books. Existing laws require all corporations to make quarterly estimated tax payments to cover income tax liabilities. These laws should be vigorously enforced. While this provision requires withholding for the purported purpose of ensuring taxes are paid, the law does not require any additional enforcement or additional reporting in order to ensure "bad apples" are not under-reporting income or over-reporting deductions. This law also requires a withholding, for the first time, that has no relation to the potential tax owed by the government contractor.

Because the withholding is required on public projects, all of our jobs are bonded. Having bonds on projects ensures the taxpayers that the jobs will be completed at no additional cost to the public. The project must be completed for the price and in the time negotiated under the contract. The construction contractor is responsible for purchasing the bond, and if something happens to the company, the bonding company liquidates the contractor's assets to complete the project. The taxpayer is protected.

Contractors must purchase several kinds of bonds for a project, but performance bonds guarantee certain tax behavior by the constructor. The performance bond ensures that payroll taxes will be paid on behalf of the employees working at that site. If the government determines that payroll taxes have not been properly withheld and remitted,

then the government can ask the bond provider to fill in the gap. The bond provider then goes after the constructor for those funds, but the taxpayer – and the employee – is protected. If the company is not paying these taxes, it will not qualify for the bond. If the company cannot get the bond, they are not qualified to bid on government contracts, or will lose their contract.

In addition to the bond provider, in many cases the agencies and construction managers that we do work for require us to pre-qualify every couple of years, and one of the questions during the process is whether we pay our taxes. The agency looks into this, and some want tax returns for two or three years for the process of verification. So again, the taxpayers are protected.

As you can see, there are several protections in current law for the taxpayer on public projects: retainage, close out costs, pre-qualification, and several layers of bonds, all paid for by the contractor during the construction process.

This new 3% withholding law is just an interest free loan to the federal government, and Congress knew that when it was passed. The Joint Committee on Taxation scored this provision as bringing in billions but also recognized that almost 97% of those billions were over withholdings that would be refunded the next tax year. This law is complicated for contractors and for the government. When the regulations came out this month the IRS delayed implementation because of the complexity. It will cost billions to implement and cost billions to comply with and enforce. It is just another layer of red-tape that creates serious cash flow problems for government contractors, in perhaps the worst industry conditions in modern times. It does not help solve a problem by using the solutions that are already on the books. It is just bad public policy. 3% withholding on government contracts will seriously impact my business and the businesses of the construction industry at large. The vast majority of the members of the contracting community are responsible taxpayers. Don't punish the whole industry because of a few bad apples.

Again, thank you for the opportunity to testify today on behalf of AGC. I appreciate the fact that 3 members of this subcommittee and 6 members of the full committee have cosponsored this legislation and I look forward to any questions that will help get the rest of you to cosponsor H.R. 674.



Testimony of Ian Frost
Principal and Founder of
EEE Consulting, Inc.

Before the House Committee on Small Business
Subcommittee on Contracting and Workforce
May 26, 2011

Chairman Mulvaney, Ranking Member Chu, and members of the committee, I appreciate the opportunity to testify today on the three percent withholding mandate, and particularly its impact on small firms that contract with federal, state, and local units of government.

My name is Ian Frost and I am the President of EEE Consulting, Inc. We are a small environmental engineering consulting firm based in Virginia. I am here today to ask for your assistance in repealing the three percent withholding rule. As you know, in 2006 Congress included a provision in the conference report for the Tax Increase Prevention and Reconciliation Act – without prior debate – that would require federal, state, and local governments that spend more than \$100 million a year on goods and services to withhold three percent from payments to engineering firms and other contractors.

I am also a member of the American Council of Engineering Companies (ACEC), the voice of America's engineering industry. ACEC members – numbering more than 5,100 firms representing hundreds of thousands of engineers and other specialists throughout the country – are engaged in a wide range of engineering works that propel the nation's economy, and enhance and safeguard America's quality of life. Over 70 percent of ACEC's members are small firms. Most have governmental clients and would be negatively affected by the three percent withholding mandate.

EEE Consulting has been in business since 1998, and during the last 12.5 years has grown to a 36-person firm based in three offices with revenue of about \$4.3 million in 2010. We are certified as a small business by the State of Virginia and meet the federal definition of a small business based on our annual revenue. About 95 percent of our work is for local, state, and federal agencies. Approximately 40 percent of our revenue comes from federal clients, primarily the Department of Energy, the Federal Highway Administration, and the Department of Defense.

During one of the most difficult economic periods since the Great Depression, we have experienced steady growth. Since the fall of 2009, we have added 13 new employees, five of whom were unemployed prior to joining our firm. Our revenue increased by about 40 percent over that period of time. We also signed an agreement to build a new office in July 2009, just before the recession struck. Despite a lot of trepidation over the economic forecasts, we stayed the course on the new building construction, secured a mortgage, and moved in during the spring of 2010.

Our success could not have occurred without a healthy cash flow because securing loans and managing cash flow for a small business is challenging at best. We have relied upon the personal finances of our owners and the company's cash reserves to buy new equipment, to pay the salaries of new employees until we get paid by our clients (which often takes many months), and to pay for the expansion of the company, including our new building. To a small business, cash flow is everything, especially during times of economic uncertainty. I am immensely proud of our past record, yet concerned about the future because the pending three percent withholding rule would negatively affect our operations.

If enacted, the rule would mean the withholding of approximately \$130,000 of revenue, using our projected 2011 revenue. This three percent withholding would essentially be a loan to the government for the year until our taxes are filed. Worse still, it might require our company to secure a loan to help us cover operating expenses at a time when cash in the bank is limited. The withholding could limit our ability to make payroll each month and limit our use of our profits to give bonuses to our employees, expand our business, and hire new employees. A \$130,000 withholding each year would deplete our cash reserves by about 30 percent. On some of our larger design build jobs for new infrastructure such as roads, we are a second or third tier consultant and it is often six to twelve months before we get paid. The three percent withholding mandate would exacerbate the

cash flow problem, especially in an industry that is transitioning to more design build contracts.

Our situation is not unique, as our trade association – ACEC – has raised serious concerns over how this mandate will impact engineering firms, including thousands of small firms like mine that work for government clients. It is important to emphasize that 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 engineering 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 such as those I outlined above.

Implementation of this mandate may also decrease business opportunities for small firms. The final regulations issued by the IRS state that the three percent withholding will apply to prime contracts but not to subcontracts. Prime contractors may be able to share the burden of the withholding under certain circumstances, but many states have “prompt pay” laws that require prime contractors to pay their subcontractors as soon as the work is completed. Bearing the full burden of the withholding may lead some prime contractors to do more work in-house, which will reduce opportunities for small firms that work as subcontractors.

Three percent withholding will also burden small firms with additional administrative and record-keeping costs. Firms will have to modify IT systems in order to keep track of the withholding from various contracts and ensure that it matches with their tax returns and tax refunds. Most small firms do not have the additional personnel required to devote to this task, and will have to divert personnel from other core responsibilities in order to be in compliance.

I am sure we agree that all taxpayers should pay the taxes they legally owe, as my firm does. I frequently hear in the news that small businesses are the economic engine for the country and are likely to be the main source of hiring that is needed to reduce our unemployment rate. Why then, would the federal government want to handcuff that economic engine by withholding a percentage of the contracts we have secured? I know that the withholding rule is intended help with tax collections, but it seems irrational to punish all firms that are involved in government contracting due to the actions of just a few.

The only solution to this problem is to repeal the three percent withholding mandate and replace it with measures that target firms and individuals that are not in compliance with the tax laws. I have attached to my testimony a list, compiled by the Government Withholding Relief Coalition, of tax compliance measures that have been enacted since the three percent withholding provision was passed in 2006. For example, in 2008 the Federal Acquisition Regulation was amended to require potential federal contractors to certify that they are in compliance with their federal tax obligations. This provision explicitly makes non-compliance with the tax code grounds for suspension and debarment. Measures such as these focus on the problem, instead of impacting firms that pay their taxes.

As an owner of a small business, I ask you to help give us relief from the burdensome and unfair withholding rule. Please find alternatives that ensure the government receives its share of our revenue through taxation but does so in a manner that does not endanger the ability of honest taxpayers to manage our cash flow, expand, add new jobs, and meet our payroll. Thank you for the opportunity to participate in today's hearing, and I would be happy to respond to any questions from committee members.



**CONGRESSIONAL TESTIMONY
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS**

SUBCOMMITTEE ON CONTRACTING AND WORKFORCE

May 26, 2011

Defer No More: The Need to Repeal the 3% Withholding Provision

Testimony of James P. Gaffney
Goshen Mechanical Contractors, Inc.
Malvern, Pennsylvania

The Quality Construction Alliance represents five specialty construction associations. These groups are: the International Council of Employers of Bricklayers and Allied Craftworkers (ICE), the Mechanical Contractors Association of America (MCAA), the Finishing Contractors Association (FCA), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), and The Association of Union Constructors (TAUC). According to Bureau of Labor Statistics figures, specialty construction employers represent more than 64% of overall employment in the construction industry.

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Introduction

Good morning Chairman Mulvaney and members of the House Small Business Committee's Subcommittee on Contracting and Workforce. Thank you, Chairman Mulvaney, for holding this important hearing today, and for inviting me and my association to participate.

My name is Jim Gaffney, and I am a principal owner of a small business mechanical construction firm, Goshen Mechanical Contractors, located in Malvern, Pennsylvania. My firm operates in the public-sector construction market throughout the greater Philadelphia area, in the Delaware Valley, and throughout Southeastern Pennsylvania. Our firm performs many public sector construction projects, such as public school new construction and retrofits and other municipal facilities. We operate both as prime contractor and subcontractor with a variety of public sector entities that will be covered by the 3 % withholding tax unfunded mandate if it is not repealed before it takes effect on January 1, 2013.

I am here today representing the Mechanical Contractors Association of America (MCAA). MCAA is a nationwide specialty construction employer trade association based in Rockville, Maryland. MCAA's member companies perform all types of mechanical, plumbing, heating and ventilating new construction and maintenance and service work for public and private project owners nationwide. The vast majority of MCAA member companies are small businesses, and many of them perform projects of the type that will be covered by the 3% withholding unfunded mandate.



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I am also President of the Mechanical Contractors Association of Eastern Pennsylvania, based in the Philadelphia area. The majority of its 100 members are small business contractors. Many of these firms also perform projects with government entities that will be covered by the 3% withholding mandate.

I am also privileged today to represent four sister specialty associations allied in an ongoing legislative initiative known as the Quality Construction Alliance (QCA). These groups are: the International Council of Employers of Bricklayers and Allied Craftworkers (ICE), the National Finishing Contractors Association (FCA), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), and The Association of Union Constructors (TAUC). According to Bureau of Labor Statistics figures, specialty construction employers represent more than 64% of overall employment in the construction industry. The majority of QCA association member companies are also small businesses, and perform a great deal of public works projects with governmental entities that will be covered by the 3% withholding mandate if it should go into effect in 2013.

I should add that many of the QCA groups also actively participate in the wider Government Withholding Relief Coalition (GWRC), which adamantly espouses rapid repeal of the 3% withholding provisions in Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. QCA fully supports that coalition's written remarks filed for the record for this hearing.



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Action Requested

Our request is simple: we would ask the subcommittee members to take the lead in vigorously pursuing the rapid repeal of the 3% withholding unfunded mandate as laid out in H.R. 674, and to take the lead in finding a legislative vehicle in this Session of Congress to finally dispatch this ill-conceived bit of public contract administration that had been added hastily in conference committee simply to score a widely overstated amount of revenue gain as a pay-for back in the 2005 Tax Reconciliation Act.

Congressmen Herger and Blumenauer and 116 co-sponsors are to be commended for their persistence in pressing for repeal again this Session. Eventually sound public policy must recognize that a well-intentioned mistake was made in Section 511 back in 2006, and that responsible policy making should own up to that reality and avoid compounding the problem by failing to take timely and effective remedial action.

The QCA couldn't agree more with the title of today's hearing – Defer No More. We are hopeful that will continue to be your motto on this important public policy issue. Once this onerous provision has been successfully repealed, you can proudly say that mistakes were confronted, adverse small business effects were avoided, further harm and fiscal waste was averted, precious public agency procurement and program dollars were saved in this time of fiscal austerity, burgeoning compliance costs were avoided, and better ways to encourage tax compliance by public contractors were instituted and encouraged. The repeal of the 3% withholding tax will be a great legacy for this subcommittee.



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Background

Section 511 of The Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) requires all government entities—Federal, state and local—to deduct and withhold from all payments made to any individual or business providing any goods or services an amount equal to 3% of the total payment. Implementation has been delayed until 2013, when government entities will be required to remit the 3% of payments to the federal government for federal income tax purposes. Government entities with less than \$100 million in annual expenditures for goods and services are exempted.

The goal of the 3% withholding provision is to stem tax avoidance by firms performing public contracts. In 2009 it was estimated that the 3% withholding tax will raise \$11 billion dollars over 10 years. According to the Internal Revenue Service (IRS), the federal government receives approximately \$345 billion less in tax revenues annually than it should receive.

Recently the IRS published its final regulations (76 FR 26583, 5/9/2011) implementing the 3% withholding, anticipating an attenuated preparation process in gearing up for implementation in 2013 – unless Congress remedies the problem before then. The regulations make the best of a bad situation – they raise the withholding threshold to invoices of \$10,000 or more, defer application for credit card payments, and, importantly for QCA, clarify application of the law to construction prime contract and subcontract payment administration by example in the regulation.



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Still, the IRS regulations highlight more regulatory, compliance issues and the questions and complications soon to come. For example, how and when will the Federal Acquisition Regulations (FAR) be amended in FAR payment contract clauses to enact and ensure the IRS's strictures against flow-down of payment withholding from prime contractors to subcontractors? Moreover, will the Office of Management and Budget (OMB) revamp its common rules for Federal grant administration to make sure that Federal grantees also respect the IRS restrictions against payment withholding flow-down from prime contractors to subcontractors? Furthermore, how will these restrictions be implemented by the many state and local government covered entities that have far less sophisticated contracting procedures as compared to FAR and OMB regulations? Simply put, Section 511 is a prime example of regulatory excess.

Important Issues for the Construction Industry

I suspect that all of the distinguished Committee Members recognize that construction projects of any scope are very complex and risky business propositions. Profit margins historically are thin, even as risks are high. When we are in a recession, as is currently the case, public works projects become all the more important, and competitive conditions can be quite tough – and margins even thinner.

The industry, even at a high level of complexity, is relatively easy to enter, which makes it an ideal market for small businesses. However, the 3% withholding could be larger than the entire profit margin on some jobs and would impede cash flow and viability for small companies doing government work.



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In the construction industry, there are a great many competitors, and price competition is keen, even on best-value selections. Additionally, low bidding or reverse auctions can further increase the risk of poor contractor selection decisions.

It really does matter how well firms are paid and how fairly construction contracts are administered. Time and again it has been proven that the best projects are the ones that are the most competently administered. Small and disadvantaged business firms can't carry the costs of public contract misadministration the way larger firms can. The law would apply to the total contract and not the total revenue; therefore some prime contractors, even larger primes, could have a cash flow issue, further complicating payment to the small business subcontractor already operating on a very thin margin.

The taxpayer interest in successful project completion is seriously jeopardized by the 3% withholding. Payment processing complexity can impair performance and cause disputes, claims, delays-- even contractor defaults. The agency procurement program then suffers, the agency mission and project is impeded, and ultimately taxpayers get less value for their dollars. All of this is being done to ensnare those firms that avoid taxes and perform public contracts – even though much more effective and efficient methods are available and in use to achieve the same goal without these overbearing risks.



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The 3% withholding is manifestly unfair to construction prime contractors and subcontractors, and to our businesses as consumers of government agency services and taxpayers.

For example, as prime contractor, under the current IRS regulations, the paying agency will hold 3% of a monthly invoice of \$48,000 – \$1,440 – even though \$18,000 of that invoice is payable to two subcontractors in amounts of \$16,000 and \$2,000, all of which the IRS regulations say must be paid in full to the subcontractors without further flow-down of the withholding. In all fairness to the prime contractor, the amount of the withholding base should be only the \$30,000 (\$900) that is payable directly to the prime contractor for its work – and against its eventual tax liability for that amount.

That's a matter of simple equity for the prime contractor, and a matter of expedient protection for the subcontractor – because without very effective, explicit, and stringent subcontract payment clause protections, in many cases that prime contract withholding will be passed down to the subcontractors, despite the IRS regulations. As the payment stream becomes more complex and burdened with regulation, the risks of adverse consequences to the project recited above become ever greater.

Fair and Prompt Payment and Fair Contract Administration is Essential to Project

Success

If anything, we should enact even broader and quicker payment terms for both direct Federal contracts and Federally assisted contracts as a way to improve project performance and enhance small and



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disadvantaged business development at the same time. Recognizing that prompt and fair payment terms are the best way to administer public contracts and avoid all the extra costs and delays that result from less efficient contract administration practices, the U.S. Congress has passed two Prompt Payment laws.

I should also point out that payment on public construction contracts is even more problematic because of the outdated and unfair practice of withholding retainage of up to 10% on each monthly invoice. Retainage is a fairly typical practice in public construction contracts generally. While there is some discretion in direct Federal construction projects under the FAR with respect to retainage, in most public works projects across the country 10% retainage on monthly invoices is common.

Yes, in construction, the service providers help finance the government project -- by having each monthly invoice discounted 10% even with satisfactory performance. With a second-tier or lower-tier subcontractor (often a small business) the delays of invoice processing and payment for only 90% of what you put out the previous month can be crushing. When the job is 50% complete, the contractor's contribution to project financing may be cut to just 5% of the monthly invoice, yet still there are the myriad risks of invoice processing and held payments by the prime contractor. Now on top of all that, the 2005 Tax Increase Prevention and Reconciliation Act would add in an additional 3% withholding -- again, even when performance is entirely up to par.

With the added specter of another 3% withholding on monthly invoices, the question is, who pays for the cost of this delayed payment? Financing isn't free.



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The answer is simple: the taxpayers will pay, in increased bids/price proposals with financing charges added to all contracts, and/or diminished competition. Small and disadvantaged businesses may be shut out further, since only larger and more well-capitalized firms will be able to absorb the added financing costs. Competition for work will be diminished, and costs will increase. Project administration costs will also increase thanks to the complex payment administration and regulation, and those resources will be taken from the procurement program and agency mission to collect IRS taxes. Again, all of this waste and overhead is meant to ensnare tax avoiders, even while more efficient methods are readily available.

Better Remedies to Stem Tax Avoidance by Public Agency Goods and Services

Providers Are Already Available

The worst part of the 3% withholding provision is that it is completely unnecessary to penalize tax-compliant law-abiding businesses to ensnare or deter tax-avoiding, non-compliant businesses. QCA is as adamantly opposed to companies receiving public contracts when they don't pay their taxes as any other responsible contracting organization. We are competitors for the work, and taxpayers too. We support H.R. 829, just approved by the Oversight and Government Reform Committee. This bill would bar individuals and companies from receiving federal contracts or grants if they have seriously delinquent tax debt.



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However, the government already has all the information it needs to address this problem without putting the burden on tax-compliant small businesses and driving some small businesses out of the market.

When I registered in Central Contractor Registration (CCR), like every other federal contractor, the government validated my taxpayer identification number with the IRS. This means that the government had all the information it needed for debt collection, and it could check at that time to see if I had any outstanding tax liabilities. When I renew my CCR registry each year, the government can again determine whether or not I have outstanding tax liabilities. I also must supply representations and certifications whenever I submit a proposal, including a statement verifying that I haven't been convicted of tax evasion.

Most importantly, since Section 511 was enacted in 2006, the Federal government instituted a Federal contractor legal compliance database - Federal Awardee Performance and Integrity Information System (FAPIIS) - which contracting officers must consult in their evaluation of prospective contractors in their contractor responsibility determinations. Moreover, in 2008 the Federal Acquisition Regulations were amended to require that prospective contract awardees present tax compliance certifications in the responsibility determinations process for all contracts above the simplified acquisition threshold of \$100,000. At the Federal level, at least, these measures are effective deterrents to tax avoiders gaining public contracts in the first place, as the risks of Federal False Claims Act punishment are a powerful disincentive to falsified claims and certifications. These types of efficient and effective safeguards,



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without penalizing tax compliant firms, could be required of Federal grantees through OMB's common rules for contracting by grantees. Covered state and local contracting entities could follow the same procedures and lead by example.

Finally, CCR shares information with agency payment systems. If someone does get a contract and owes tax liability, the government should be able to withhold the funds at that time. Some agencies already do so. The important thing to remember here is that the government can do all of these things without costing law-abiding small businesses a single penny.

Put plainly, fiscal enforcement policy and sound procurement policies should not be mixed. To be sure, small and disadvantaged businesses, as well as all other responsible firms, shouldn't have to compete against firms that have the unfair competitive advantage of undetected tax avoidance. Burdening tax compliant firms with added withholding to encourage tax payments by those otherwise inclined to cheat is truly robbing Peter to pay Paul. The GWRC estimates that compliance costs dwarf IRS revenue gains by a factor of nearly 10. For the \$75 billion spent in administrative collection and contract financing costs, the IRS realizes a tax gain of just \$11 billion.

Our Quality Construction Alliance is squarely in favor of closing the tax gap. The taxpayers, public agencies and our industry benefit by fair and robust competition among quality firms that are responsible in all aspects of their business. If stopping tax avoidance by public agency goods and service providers is the target, then there are more specific tools available to achieve that goal. The



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contract eligibility process should be tightened up so that successful bidders or offerors are not awarded contracts unless they demonstrate, prove and certify tax compliance. In this way, any competitive advantage of tax cheaters is eliminated, the agency gets quality work by qualified firms, and the added financing and administrative cost of overbroad withholding is avoided.

Conclusion

Please support and pass H.R. 674 as rapidly as possible.

Respectfully submitted:

James P. Gaffney

For the Quality Construction Alliance:

International Council of Employers of Bricklayers and Allied Craftworkers (ICE)

Mechanical Contractors Association of America (MCAA)

National Finishing Contractors Association (FCA)

Sheet Metal and Air Conditioning Contractors' National Association (SMACNA)

The Association of Union Constructors (TAUC)

STATEMENT OF KARA M. SACILOTTO, WILEY REIN LLP
BEFORE THE SUBCOMMITTEE ON CONTRACTING AND WORK FORCE
OF THE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

"DEFER NO MORE: THE NEED TO REPEAL THE 3% WITHHOLDING PROVISION"

MAY 24, 2011

I. INTRODUCTION

Chairman Mulvaney, Ranking Member Chu, and members of the subcommittee, thank you for the invitation to participate in today's hearing. My name is Kara M. Sacilotto. I am a partner with the law firm Wiley Rein, LLP, and practice in the firm's government contracts practice group. I also have the privilege of teaching government contracts as an Adjunct Professor at George Mason University School of Law. My testimony today is not provided on behalf of any institution, organization or entity and represents solely my own personal views as a practitioner in the area of government contracting.

I am confident that you have heard and will hear from businesses -- both large and small -- and industry groups that the three percent withholding on payments from federal, state, and local governments established by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) is bad for business during already stressful economic times. The law unfairly penalizes honest taxpaying contractors, bears no relationship to ultimate tax liability for those against which payments are withheld, and will be extraordinarily burdensome to administer. I echo these concerns, but in addition to these direct, negative impacts on contractors and governments, Section 511 also will inflict unnecessary burdens and harms on the procurement system itself. Although these impacts are likely felt at the state and local level as well, I will focus on three impacts to the federal procurement system: (1) the undermining of existing policies and programs to foster small business contracting with the federal government; (2) the disincentive Section 511 creates for contractors to do business with the government; and (3) increased costs to contractors and the government and disputes between contractors and procuring agencies as a result of Section 511. I will also discuss existing protections for the government in the procurement system that render the three percent withholding unnecessary in light of its burdens.

II. OVERVIEW OF THE THREE PERCENT WITHHOLDING REQUIREMENT AND IRS IMPLEMENTING RULES

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), Pub. L. No. 109-222, added section 3402(t) to the Internal Revenue Code (IRC) and, with certain limited exceptions, requires federal, state and local governments (including political subdivisions and instrumentalities with total annual payments in excess of \$100,000,000) to deduct and withhold as a tax three percent of *any* payment to *any* person providing property or services to federal, state, and local governments. TIPRA slated the withholding to go into effect for payments made after December 31, 2010. Section 1511 of the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, extended the effective date of section 3402(t) to payments made after December 31, 2011. In response to public comments regarding administrative implementation burdens associated with the withholding requirement, the Internal Revenue Service (IRS), which recently issued final rules to implement the withholding requirement, granted contractors and governments an additional one-year extension from the ARRA implementation date.¹ Thus, under the final rule, the withholding will apply to any individual payment of \$10,000 or more made after December 31, 2012, subject to an exception for payments made under contracts existing on December 31, 2012, that are not materially modified. This exception may be temporary only, however: on May 9, 2011, the IRS also issued a proposed rule that includes a sunset provision under which the “existing contract” exception would cease to apply to any payments made on any contract on or after January 1, 2014.² Thus, if finalized, the withholding will apply to all payments over \$10,000 made after

¹ See 76 Fed. Reg. 26583 (May 9, 2011).

² See 76 Fed. Reg. 26678 (May 9, 2011).

January 1, 2014 on any contract, regardless whether the parties contemplated such a withholding when they entered into the contract.

The IRS's delay of implementation of the withholding is a good idea, but the final rules still do not shield taxpaying contractors that meet their legal obligations from the harmful impacts of the rule. For example, public comments requested that the IRS refrain from applying the withholding to industries with low profit margins, if the payee expected that it would not have any income tax liability (if, for example, the contractor anticipated net operating *losses*), or if the taxpayer was current on its taxes. The IRS declined to establish such exceptions in its implementing rules, noting that "differing rates for differing industries or taxpayers are not contemplated by the statute and would raise administrative complexities."³ Thus, even businesses that anticipate no tax liability or timely pay corporate income taxes will be subject to a three percent withholding.

Commenting parties also requested that the IRS clarify that the withholding would not apply to a variety of payments for work-in-progress, such as contract financing payments, performance-based payments, commercial advance payments, interim payments, progress payments based on cost or percentage of completion, or interim payments on cost-reimbursement contracts. These interim payments are intended to help finance a contractor's ongoing contract performance, and comments argued that withholding portions of the interim payments would detrimentally affect cash flow and increase costs to governments, and that additional withholding was unnecessary where the government already withholds a portion of payment until contract completion. The IRS rejected all of these comments because a more nuanced application of the

³ 76 Fed. Reg. at 26586-87.

withholding also would add “administrative complexity.”⁴ According to the IRS, “[t]reating the date the funds are disbursed as the payment date ensures that there will be funds upon which to withhold.”⁵ Thus, it appears that ensuring that there are funds to withhold is deemed more important than allowing contractors to realize a stable cash flow.

Despite the much-needed additional delay and the finalization of implementation rules, the IRS’s rules still leave much regulatory work to be done. Because existing provisions of the Federal Acquisition Regulation (FAR) and its implementing clauses do not reflect this withholding requirement, significant revisions to the FAR will be required in the areas governing contract administration and payments, among others. The IRS took over two years to issue final rules on implementation of Section 511, and a further proposed rulemaking is still outstanding. The additional process of promulgating, commenting upon, and finalizing new FAR rules, incorporating these new rules and clauses in future solicitations, and potentially seeking to add them to existing contracts is an administrative burden on government and contractors that remains outstanding and should be avoided.

III. **PROCUREMENT IMPLICATIONS IF THE 3% WITHHOLDING RULE IS NOT REPEALED**

A. **The Withholding Requirement Impairs Procurement Policies Designed To Promote Opportunities for Small Businesses to Contract with the Federal Government.**

Congress and regulators have established numerous programs to assist small businesses with contracting with the federal government. These programs and policies include, among other things:

⁴ *Id.* at 26586.

⁵ *Id.*

- Small business set-aside contracts, including the requirement that a contracting officer “set aside” for small businesses any contract over \$150,000 where there is a reasonable expectation of receiving offers from at least two responsible small businesses and award can be made at a fair and reasonable price;⁶
- The policy expressed in FAR 52.219-8 that “small business concerns, veteran-owned small business concerns, service-disabled veteran-owned small business concerns, HUBZone small business concerns, small disadvantaged business concerns, and women-owned small business concerns *shall have the maximum practicable opportunity to participate in performing contracts let by any Federal agency . . .*” and that federal government prime contractors will carry out the policy to the fullest extent possible in awarding subcontracts and “establish procedures to ensure the timely payment of amounts due” to small business concerns;⁷
- Small business subcontracting requirements, including the requirement in FAR 52.219-9 that a federal prime contractor provide a small business subcontracting plan that addresses, among other things, goals for subcontracting with various small businesses, the dollars planned to be subcontracted, and the types of services and supplies to be subcontracted;
- Specific small business government contracting programs, including the 8(a) Business Development, HUBZone, Service-Disabled Veteran-Owned and Women-Owned Small Business programs;⁸
- Mentor-protégé programs through the Small Business Administration (SBA), the Department of Defense (DoD) and other agencies; and
- The Small Business Innovation Research (SBIR) program as well as small business loans from the SBA;
- Policies to strengthen the ability of small businesses to compete for federal contracts included in the Small Business Jobs Act of 2010, Pub. L. No. 111-240; and
- Administration efforts, as part of the U.S. Chief Information Officer’s December 2010 25-point plan to reform federal information technology management, to reduce existing barriers to entry for small, innovative businesses.⁹

⁶ FAR 19.502-2(b).

⁷ FAR 52.219-8 (emphasis added).

⁸ 13 C.F.R. Parts 124 – 127.

⁹ Vivek Kundra, U.S. Chief Information Officer, “25 Point Implementation Plan to Reform Federal Information Technology Management at 20 (Dec. 9, 2010), available at: <http://www.cio.gov/documents/25-Point-Implementation-Plan-to-Reform-Federal%20IT.pdf>.

Section 511 of TIPRA undermines all of these governmental policies designed to assist small and small disadvantaged business with contracting with the federal government. The SBA Office of Advocacy, established by Congress to advocate and represent the views of small business before federal agencies and Congress, has spoken out bluntly against Section 511 and its harmful effect on all small businesses:

The three percent withholding requirement will adversely impact all small businesses that provide services to Government entities. Most small businesses that provide services to Government entities will have to increase their debt level in order to ensure sufficient cash flows and will be forced to pass these added additional expenses on to their Government customers. The three percent withholding requirement will force many other small firms that are unable to secure additional debt out of the Federal contracting business.¹⁰

In commenting on the IRS's implementation rules, the Department of Veteran Affairs expressed similar concerns regarding the impact of the withholding on small businesses with which it contracts:

VA contracts with many small, minority-owned, and veteran-owned businesses and withholding three percent from their payments will significantly reduce cash flows. Complying with the proposed regulations may force these companies to alter their business models or pricing schemes, or to stop doing business with VA and the Federal Government.¹¹

The Department of Housing and Urban Development (HUD) also noted the adverse impact on small businesses and the likely negative impact on HUD's ability to contract with small businesses:

¹⁰ Comments of the SBA Office of Advocacy on Notice 2008-38, "Government Entities Required to Withhold Three Percent on Payments for Services and Property," at 1 (Apr. 24, 2008); *see also* SBA Office of Advocacy Press Release "Chief Counsel Applauds IRS Postponement of Three Percent Withholding Tax on Contractors," available at: <http://www.sba.gov/content/chief-counsel-applauds-irs-postponement-three-percent-withholding-tax-contractors>.

¹¹ Department of Veteran Affairs, Comments on the Proposed Regulations concerning Withholding Under Internal Revenue Code Section 3402(t) (Mar. 3, 2009).

The majority of small businesses that contract with the federal government are under the \$23 million size limitation and a good portion of these companies are under the \$6 million size limitation. This regulation will undoubtedly increase the overhead of many small businesses through having to enhance their internal accounting (financial and project) software to account for and report withheld amounts. The increased overhead cost may force small businesses to increase their contract pricing to cover those costs. Also, the 3 percent withholding, albeit small, could account for half their profit margin, creating a hardship due to cash flow demands.

* * *

The impact on small businesses may potentially result in good vendors choosing to not participate in HUD's contracting opportunities. This would have the net effect of reducing HUD's available pool of small businesses capable of receiving HUD contracts, which is contrary to the Department's stated policy of providing maximum practicable opportunities in HUD's acquisitions to small businesses. Reduced competition for HUD's contracts may well increase contract pricing.¹²

Although nothing in the withholding law exempts any contractor – large or small – from having to pay its suppliers and vendors, the impact on small businesses will be particularly acute for all of the reasons these agencies and small businesses themselves have identified. In recognition that small businesses have more vulnerable cash flow issues, the FAR includes accommodations for small business concerns. For example, although the customary progress payment rate for large businesses is 80 percent of the total costs of performing the contract, small businesses may receive 85 percent as part of their progress payments.¹³ The DoD FAR Supplement (DFARS) includes additional policies to assist small businesses. Although the standard progress payment for large businesses under DoD contracts is the same 80 percent the

¹² HUD Response to IRS on 26 CFR Part 31 Section 3402(t) Known as Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (Mar. 5, 2009).

¹³ See, e.g., FAR 32.501-1.

FAR provides, small businesses receive progress payments at a 90 percent rate, and small, disadvantaged businesses are paid at a 95 percent rate.¹⁴ DoD also has adopted a policy to pay small businesses as quickly as possible after invoices are received and before the normal due date for payment.¹⁵ On April 27, 2011, DoD issued a class deviation to foster these accelerated payments to small businesses.¹⁶ A withholding of three percent of payments as applied to small businesses is inconsistent with these policies and initiatives and reduces the benefits of prompt payments and increased progress payments.

None of these programs or policies can function properly if small businesses are otherwise discouraged from contracting with the government because they cannot generate the revenues or cash flow to meet their expense obligations. As the SBA Office of Advocacy, Department of Veterans Affairs, HUD and others have noted, because contractors' reduced cash flow must be replaced, if even possible, with additional interest expense on borrowing or reduced margins, Section 511 may drive small businesses from the federal market, even when the government has other policies designed to encourage their participation.

B. The Withholding Requirement Is A Disincentive to Commercial Item Contractors.

Although some companies may reluctantly accept providing, in essence, an interest-free loan to the government as a condition of doing business, a blanket three percent withholding on payments also will almost certainly discourage new companies from doing business with the federal government, particularly those companies that have been hesitant to enter the federal

¹⁴ DFARS 232.501-1.

¹⁵ See Interim Rule, 76 Fed. Reg. 23505 (Apr. 27, 2011) (amending DFARS to accelerate payments to all small businesses, not only small disadvantaged businesses).

¹⁶ Memorandum 2011-O0007, "Class Deviation – Requirement for Accelerated Payments to Small Businesses (Apr. 27, 2011), available at: <http://www.acq.osd.mil/dpap/policy/policyvault/USA001787-11-DPAP.pdf>.

marketplace. Specifically, in addition to impacting negatively policies and programs intended to promote small business participation in contracting, the three percent withholding will likely disproportionately dissuade commercial item contractors, including small businesses that offer high tech products that might be available on the commercial market, from selling to or entering the government market, despite government efforts to encourage their participation. Commercial item vendors, in particular, have little incentive to finance the government's operations with their revenues, especially if they are able to operate profitably in a commercial sector that does not exact that toll.

Congress has enacted laws intended to encourage companies that sell commercial items and commercial off-the-shelf items, both defined in the FAR, to sell their products to the government on terms and conditions, including pricing, that reflect the commercial market.¹⁷ The Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, states a preference for government acquisition of commercial items based on the determination that these products can save the government research and development costs, minimize acquisition lead-time, and reduce the need for detailed product design and testing.¹⁸ Another goal of commercial item contracting is to allow government to reap the benefits of commercial prices. Indeed, this is one of the objectives of the General Services Administration (GSA) schedule program.

To make contracting with the government more attractive to commercial item vendors, various regulatory requirements do not apply to commercial item contracts, such as compliance with the government's Cost Accounting Standards and the requirement to provide detailed cost and pricing information under the Truth in Negotiations Act, among others. The FAR also

¹⁷ See FAR 2.101. This provision defines both a "commercial item" and "commercial off-the-shelf" items.

¹⁸ S. Rep. No. 103-258 at 5 (1994).

provides a streamlined version of contract provisions for commercial item contracts intended, to the extent possible, to mirror commercial practices.¹⁹ The National Defense Authorization Act of 2008, Pub. L. No. 110-181, also directed DoD to develop a plan to minimize the number of “government-unique” clauses in commercial item contracts.²⁰

Just as the efforts to promote small business participation in federal contracting will be undermined by Section 511, so too will efforts to encourage commercial item contractors to enter and stay in the federal market. Even with laws and regulations designed to ease the burden for acquisition professionals and commercial item vendors to contract for commercial items, contracting with the government still comes with “bureaucratic strings.” Over time, these “strings” have increased, slowly chipping away at the notion that commercial item contracting in the federal sector should mirror the commercial sector. Recent examples of additional regulatory burdens applied to commercial item contractors who deal with the government (but not imposed in the commercial market) include the requirement to disclose, under certain circumstances, executive compensation of the commercial item vendor and even its first-tier subcontractors,²¹ to make updates to information in the Federal Awardee Performance and Integrity System (FAPIIS) database, much of which will be disclosed publicly,²² and mandatory disclosure to agency inspector generals of credible evidence of violations of certain criminal laws, the civil False Claims Act, and overpayments by the government.²³

¹⁹ FAR 51.212-4.

²⁰ Pub. L. No. 110-181, § 821.

²¹ FAR 52.204-10.

²² See 75 Fed. Reg. 14059, 14063 (Mar. 23, 2010); FAR 12.301(d)(3)-(4).

²³ 73 Fed. Reg. 67064 (Nov. 12, 2008); FAR 52.203-13(b)(3).

The three percent withholding, and the costs of complying with and administering it, is yet another added cost of doing business with the federal government that exists nowhere in the commercial marketplace. Given a choice of customers, it is reasonable to believe that vendors of commercial items will forego the additional penalty of a three percent withholding that comes with contracting with the government, reducing competition for acquisitions of commercial items and depriving government of innovative, commercial products. Moreover, the government may now find that it must pay a premium for commercial items, since the costs of dealing with the government no longer reflect the costs of the commercial marketplace.

C. The Withholding Requirement Will Likely Result in Higher Costs for the Government and Disputes Between Contractors and the Government.

Putting aside that contractors whose contracts incorporate the withholding requirement will likely pass on to the government the costs of administering and obtaining additional financing as a result of the withholding, the withholding imposes even more potential costs in terms of disputes between agencies and contractors.

As discussed above, the IRS's final implementing rules exempt contracts existing as of December 31, 2012, unless the contract is "materially modified."²⁴ A "material modification" is defined in the IRS rules as "a modification that materially affects the property or services to be provided under the contract, the terms of payment for the property or services under the contract, or the amount payable for the property or services under the contract."²⁵ It does not include "a mere renewal of a contract that does not otherwise materially affect" the property and services provided, terms of payment, or payment amount.²⁶ It also does not include a modification to a

²⁴ 26 C.F.R. § 31.3402(t)-1(d)(2).

²⁵ *Id.*

²⁶ *Id.*

contract required by applicable federal and state law.²⁷ Because, as discussed below, most government contracts allow the government to make changes to the contract, changes to the property or services provided under a contract – and an adjustment to the contract price if the contractor’s costs of performance are impacted – are not uncommon. If allowed to go into effect, this “material modification” qualification will foreseeably lead to extensive disputes regarding what changes constitute a “material” modification.

In addition, the IRS has proposed a rule that would apply the three percent withholding to all payments under any procurement contract, *including* those in effect on December 31, 2012, starting with payments in January 2014. There are no FAR rules that implement the withholding requirement at this time. Nevertheless, changes to the FAR generally apply only to solicitations (and therefore contracts) issued *after* the effective date of the FAR change.²⁸

Plainly, any attempt to impose a three percent withholding on all contracts entered into *prior to* the effective date of Section 511 will lead to disputes regarding the government’s authority to modify the parties’ contractual bargain and, at a minimum, will expose the government to claims for compensation. Government contracts, not surprisingly, include clauses governing payments. Some clauses provide for payment upon completion or partial delivery of supplies; others, as discussed above, provide for payments to the contractor as work progresses.²⁹ With respect to progress payments, clauses may provide for payment on the basis of the costs incurred as work progress or based upon a percentage of work completed or the stage of contract completion. None of these payment clauses, however, incorporates a three percent withholding

²⁷ *Id.*

²⁸ FAR 1.108(d)(1).

²⁹ *See, e.g.*, FAR 52.232-1 (standard payment clause for accepted delivery of supplies or services and accepted partial deliveries); FAR 52.232-16 (progress payments).

on payments for income taxes. The standard commercial item contract terms included in the FAR similarly provide that payment must be made upon government acceptance and in accordance with the Prompt Payment Act.³⁰ Unlike some terms of FAR 52.212-4 that can be tailored by the parties, the payment clause cannot, except to implement electronic funds transfer under FAR subpart 32.11.³¹

Government contracts also include a Changes clause that allows the contracting officer to make changes within the general scope of the contract. With respect to fixed-price contracts for supplies, for example, the contracting officer can make changes to (1) drawings, designs, or specifications when supplies are provided according to government specifications; (2) the method of shipping or packing; and (3) the place of delivery.³² For service contracts, the contracting officer may make changes to (1) the description of services to be performed; (2) the time of performance, such as the days of the week or hours of the day; and (3) the place the services are performed.³³ For commercial item contracts, changes in the terms and conditions of the contract can be made only by mutual written agreement of the parties.³⁴ None of these provisions permits the government to modify an existing contract to withhold, unilaterally, payments to a contractor. Moreover, even when these provisions *do* apply, the contractor is entitled to an equitable adjustment in the contract price to compensate it for the costs of the change.³⁵ In short, the government is not entitled to make a change to the contract that affects

³⁰ FAR 52.212-4(i).

³¹ FAR 12.302(b).

³² FAR 52.243-1(a).

³³ FAR 52.243-1(a), Alt. I.

³⁴ FAR 52.212-4(c).

³⁵ FAR 52.243-1(b); FAR 52.243-1(b), Alt. I.

the contractor's costs for *free*. For those contracts that were entered into prior to enactment of TIPRA or the effective date of Section 511, the government cannot simply impose a three percent withholding without compensation to the contractor.³⁶

Beyond the myriad disputes that will foreseeably arise attempting to enforce and implement Section 511, it is also likely that disputes will arise in reconciling withholdings under the statute. To the extent the IRS has described the processes for corrections to over-withholdings and under-withholdings, they are complex and do not appear to cover all the issues that will likely arise. In particular, it is not entirely clear how contracting officers and contractors will "true up" the amounts withheld to determine whether the government has over or under-collected its taxes. Beyond the attempts to impose this withholding on existing contracts, the simple mechanics of dealing with this new process are likely to generate disputes.

The Supreme Court has recognized that the government has a "long-run interest as a reliable contracting partner."³⁷ Section 511 disrupts this "long-run interest" considerably. Because neither the FAR nor other areas of the law allows the government to enact laws that "undo" the bargains struck with contracting partners without contractual repercussions, Section 511 will inevitably generate a host of disputes and additional costs under existing contracts.

D. The Procurement System Already Provides The Government Tools to Protect Itself from Contracting with Delinquent Contractors.

Finally, to the extent TIPRA is intended to protect the government from delinquent taxpaying contractors, other laws already exist to target contractors who are delinquent on taxes and to protect the federal government from doing business with tax-delinquent contractors

³⁶ FAR 1.108(d)(3) ("Contracting officers may, in their discretion, include the changes in an existing contract *with appropriate consideration*") (emphasis added).

³⁷ *United States v. Winstar Corp.*, 518 U.S. 839, 843 (1996) (Souter, J., for the plurality).

without needlessly and unfairly burdening contractors who abide by their legal obligations. Beyond existing Treasury Department enforcement tools, the procurement system also has mechanisms to incentivize contractors to meet their tax obligations and to protect the government from those that do not. Federal law requires that only contractors who are “responsible” can be awarded contracts, and the contracting officer is required to make an affirmative determination of the contractor’s responsibility prior to awarding a contract.³⁸ Two aspects of this determination include evaluation of the contractor’s financial resources and record of integrity and business ethics.³⁹ To assist contracting officer’s in making a responsibility determination, FAR 52.209-5 requires contractors submitting proposals for federal contracts to make various certifications regarding their “present responsibility.” On April 22, 2008, this FAR provision was amended, effective May 22, 2008, to require contractors submitting proposals for federal procurement contracts to certify whether “within a three-year period preceding this offer,” the contractor has or has not “been notified of any delinquent Federal taxes in an amount that exceeds \$3,000 for which the liability remains unsatisfied.”⁴⁰ A similar provision applies to solicitations for the acquisition of commercial items.⁴¹ At the same time, the FAR was amended to provide that a contractor can be suspended or debarred from contracting with the government entirely for being delinquent in federal taxes in an amount over \$3,000.⁴²

In addition, on January 20, 2010, the White House issued a memorandum requiring the IRS to review contractor certifications regarding non-delinquency in taxes under FAR 52.290-5

³⁸ FAR 9.103.

³⁹ FAR 9.104-1(a), (d).

⁴⁰ FAR 52.209-5(a)(1)(i)(D).

⁴¹ FAR 52.212-3.

⁴² FAR 9.406-2(b)(v).

and 52.212-3.⁴³ The Memorandum also requires the Office of Management and Budget to evaluate practices of contracting officers and debarring officials in response to contractors' certifications of tax delinquencies and to provide recommendations on process improvements to ensure that these delinquent contractors are not awarded federal contracts and to make contractor certifications available in a government-wide database.⁴⁴

With respect to this final recommendation, Section 872 of the National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417, required GSA to create a database containing specific information on government contractors' integrity and performance – the FAPIIS database previously referenced. Currently, FAPIIS includes information on civil, criminal and administrative findings of liability and penalties over \$5,000, and serves as a “one-stop” shop for contracting officers to find information on whether a prospective contractor is “presently responsible” and thereby eligible to receive a federal contract. Regulators have also explored expanding FAPIIS to include information regarding state contracts and other proceedings.⁴⁵

As a result of these provisions, contractors today have a strong incentive to pay their taxes to receive future contracts awards and avoid the contractual “death sentence” of suspension or debarment that would preclude them from participating in federal contracting. Because contractors may face civil or even criminal liability under the False Claims Act for knowingly false certifications, they also have a strong incentive to answer these certifications truthfully.

⁴³ See White House, Office of the Press Secretary, Memorandum for the Heads of Executive Departments and Agencies (Jan. 10, 2010), available at: <http://www.whitehouse.gov/the-press-office/memorandum-heads-executive-departments-and-agencies-1>.

⁴⁴ *Id.*

⁴⁵ See, e.g., 75 Fed. Reg. 14059, 14060 (Mar. 23, 2010) (FAR Councils exploring inclusion of information on performance of state government contracts and other violations of law not only in the context of federal contracts and grants).

Moreover, the government already has the tools necessary to identify contractors who are delinquent on the taxes and ensure that the government does not contract with these contractors. Given the tools already available to target delinquent contractors, Congress should repeal Section 511 and avoid the significant burdens and negative impacts of an across-the-board withholding on government and tax-paying contractors.

IV. CONCLUSION

Chairman Mulvaney and members of the Subcommittee, although the delays to implementation of Section 511 of TIPRA are welcomed, the federal procurement system, like commercial markets, favors stability. I urge you to take action to repeal Section 511 of TIPRA now before the negative consequences I have discussed are unnecessarily inflicted on the procurement system. Thank you again for this opportunity to share my views.

Statements for the Record

Airports Council International-North America

American Farm Bureau Federation

AICPA

American Healthcare Association

American Logistics Association

American Medical Association

American Trucking Association

Associated Builders and Contractors Inc.

The Coalition for Government Procurement

CTIA the Wireless Association

The Computing Technology Industry Association

Construction Industry Round Table

Energy Systems Group

The Engineering and Utility Contractors Association

Florida Airports Council

Government Withholding Relief Coalition

Miami-Dade Board of County Commissioners

National Association of College and University Business Officers

National Association of Manufacturers

National Association of Surety Bond Producers

National Association of State Auditors, Comptrollers and Treasurer

National Defense Industrial Association

National Electrical Contractors Association

National Roofing Contractors Association

Orange County Board of Supervisors

Riverside County Board Supervisors

Santa Barbara County Board of Supervisors

The University of Illinois

U.S. Chamber of Commerce

Women Construction Owners & Executives, USA

Women impacting Public Policy (WIPP)

Ventura County Board of Supervisors



The Honorable Sam Graves
Chairman
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
House Small Business Committee
B343 Rayburn House Office Building
Washington, DC 20515

The Honorable Mick Mulvaney
Chairman
Subcommittee on Contracting
and Workforce
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Contracting
and Workforce
B343 Rayburn House Office Building
Washington, DC 20515

May 26, 2011

Dear Chairman Graves, Ranking Member Velazquez, Subcommittee Chairman Mulvaney, and Subcommittee Ranking Member Chu:

Airports across the country are concerned about the implementation of the 3% withholding law mandated by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. ACI-NA has opposed this provision since its passage and has worked to delay its implementation and repeal the provision. We very much appreciate you holding this hearing today to explore the impact of the provision on different industries.

The attached letter shows the concern of airports across the country ranging from small hubs to large hubs, illustrating that not only airports, but businesses of all sizes are opposed to the implementation of the 3% withholding law. The airport industry believes that the administrative burden of this requirement will create a financial burden. In addition, we also have great concerns regarding the impact of the 3% withholding law on construction costs as we believe this provision will make those costs increase.

We ask that you strongly consider the important points made by airports as you debate the merits of the 3% withholding law and look for any and all opportunities to not only further delay its implementation but also to repeal the provision from law.

Sincerely,

A handwritten signature in black ink, appearing to read "Greg Principato". The signature is stylized with a large initial "G" and a long horizontal stroke extending to the right.

Greg Principato
President
Airports Council International-North America

The Honorable Sam Graves
Chairman
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
House Small Business Committee
B343 Rayburn House Office Building
Washington, DC 20515

The Honorable Mick Mulvaney
Chairman
Subcommittee on Contracting
and Workforce
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Contracting
and Workforce
House Small Business Committee
B343 Rayburn House Office Building
Washington, DC 20515

May 26, 2011

Dear Chairman Graves, Ranking Member Velazquez, Subcommittee Chairman Mulvaney, and Subcommittee Ranking Member Chu:

We are writing to express our opposition to the 3% withholding requirement which is set to be implemented in 2013. As public entities, airports are particularly concerned about the implications of the preparations for and actual implementation of the 3% withholding requirement will have on our individual airports as well as the industry as a whole.

As you prepare to hold a hearing on the impacts that this regulation, we ask that you consider the effect we believe it will have on airports. The financial burden of the implementation of this regulation comes at a time when airports are facing historic reductions in federal funding. Furthermore, we have significant concerns about how this requirement will alter current contracts and long-term plans for infrastructure improvements. Since multi-year contracts airports currently have do not account for the 3% withholding, those contracts will need to be altered in order to meet the requirement. These changes will come at a financial cost.

Airports are also concerned about construction costs increasing due to this regulation. As contractors will see 3% less than the negotiated amounts in their payments, we believe that contractors will increase their costs to compensate for the new withholding. This will result in higher construction costs paid by airports and thus local communities for projects.

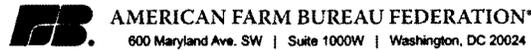
It is the function of the federal government to assess and collect federal taxes. We currently play the role of landlord at our facilities and having to also become the federal tax collector under the

3% withholding law will weaken our ability to successfully manage and negotiate the best prices to meet our local communities' air service needs.

The airport community strongly opposes the implementation of the 3% withholding law. We ask that you work to repeal this unprecedented federal mandate as soon as possible.

Sincerely,

Denver International Airport
Fresno Yosemite International Airport
Greater Orlando Aviation Authority
Kansas City International Airport
McCarran International Airport
Metropolitan Nashville Airport Authority
Port of Portland
The Raleigh-Durham Airport Authority
Salt Lake City Department of Airports
Tucson Airport Authority



AMERICAN FARM BUREAU FEDERATION*
600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024

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www.fb.org

February 28, 2011

Dear Senator:

Farm Bureau supports S. 89 by Sens. David Vitter (R-La.), Richard Burr (R-N.C.), James Inhofe (R-Okla.), Johnny Isakson (R-Ga.) and Roger Wicker (R-Miss.), and S. 164 introduced by Sens. Scott Brown (R-Mass.) and Olympia Snowe (R-Maine) to repeal the 3 percent withholding on government payments for goods and services that is scheduled to begin in 2012. We urge you to cosponsor this important legislation.

The conference report for the Tax Increase Prevention and Reconciliation Act of 2005 states that farm programs are explicitly intended to be covered by the new 3 percent withholding tax. For example, if a farmer or rancher would receive a \$10,000 payment for protecting streams or rivers under the Conservation Reserve Program, \$300 would be withheld from the payment. A partial list of other USDA payments on which farmers and ranchers depend that will be affected are:

- Direct payments;
- Counter-cyclical support payments;
- Average Crop Revenue Election (ACRE);
- Dairy support programs;
- Specialty crop block grants;
- Supplemental disaster program payments; and
- Conservation programs – the Conservation Stewardship Program (CSP), the Conservation Reserve Program (CRP) and the Environmental Quality Incentives Program (EQIP)

Imposing a withholding on USDA payments will create a financial hardship on farm and ranch operations. Farm profitability and tax liability fluctuate greatly from year to year due to weather and markets, but the tax will be withheld regardless. For agricultural operations that end the year without owing taxes, the withholding amounts to an interest-free loan to the government.

The withholding also has the potential to disrupt farm and ranch business planning. Farm and ranch inputs are often purchased months before a commodity is sold. Reducing revenue by 3 percent of government payments could create cash flow problems and make it harder for agricultural producers to purchase the supplies they need to operate their farms and ranches.

Finally, when taxes are withheld on emergency and disaster program payments, the amount of assistance provided to farms and ranches affected by floods, droughts, freezes and other natural disasters will be reduced. Reducing emergency assistance at the time it is most needed by farmers and ranchers makes little sense.

Farm Bureau asks you to cosponsor S. 164 and/or S. 89 to repeal the 3 percent withholding tax on government payments for goods and services. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Bob Stallman', with a long horizontal flourish extending to the right.

Bob Stallman
President



American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

**STATEMENT OF PATRICIA A. THOMPSON
ON BEHALF OF THE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**BEFORE THE
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON
DEFER NO MORE: THE NEED TO REPEAL THE 3 PERCENT
WITHHOLDING PROVISION**

MAY 26, 2011

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS TESTIMONY**BEFORE THE
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES****HEARING ON DEFER NO MORE: THE NEED TO REPEAL THE 3 PERCENT
WITHHOLDING PROVISION****MAY 26, 2011**

Good morning Chairman Mick Mulvaney, Ranking Member Judy Chu, and the Members of the Subcommittee. My name is Patricia A. Thompson. I am a CPA and am submitting this statement as Chair of the American Institute of Certified Public Accountants ("AICPA") Tax Executive Committee. I am the tax partner with Piccerelli, Gilstein & Company, LLP, Providence, Rhode Island; and my clients include many closely held businesses in the manufacturing, service and real estate industries. The AICPA thanks this Subcommittee for the opportunity to submit this written statement today for the hearing on the need to repeal section 3402(t) of the Internal Revenue Code, requiring federal, state and local governments generally to withhold 3 percent on certain payments.

The AICPA strongly urges Congress to repeal the 3 percent withholding on payments made to government contractors, and for Medicare, farm, and certain other payments. The original effective date for the provision was set for January 1, 2011, but was delayed until January 1, 2012 as a result of the 2009 signing into law of the American Recovery and Reinvestment Act. On May 9, 2011, the Internal Revenue Service issued the final regulations on 3 percent withholding which included a further one-year delay in the effective date until January 1, 2013.

While we welcome the IRS's action to further delay the provision's effective date, we continue to urge Congress to repeal the 3 percent withholding law because compliance will likely remain extremely burdensome for state and local governments, government contractors, medical service providers, farmers, and others concerned. Without compelling evidence of non-compliance by these persons and business entities in terms of non-payment of their federal tax liabilities, the additional burden may not be necessary. In fact, the IRS already has a number of tools in place to address taxpayers with federal tax liabilities without the need for governments to resort to 3 percent withholding on payments. Some of these tools include (among others): (1) the Federal Awardee Performance and Integrity Information System, involving a federal (legal and tax compliance) database that government employees and grant officials are required to review before awarding a federal prime contract; and (2) tax compliance certifications, requiring government contractors to certify that the offeror and its principals have no delinquent federal taxes with a delinquency grounds for suspension and disbarment.

Our CPA members who provide services to state and local governments are hearing that these governmental entities consider the 3 percent withholding law to be an unfunded mandate,

causing significant challenges for governmental accounting and procurement systems. Similarly, state and local governments are also informing our members that this need to reprogram systems (to comply with the law) will likely prove a costly task, particularly during a period of budgetary imbalances and difficult economic times.

We also support repeal of 3 percent withholding because of the potentially harmful impact that the law will have on businesses engaged in government contracting. For example, should a company have 3 percent withholding imposed on the services it provides as a government prime contractor, the company might find it extremely difficult to adjust subcontractor arrangements to pass the timing and cost of withholding on to the subcontractors. This issue alone represents the potential for notable impact on contractor cash flows and financing and administrative costs. The impact of the withholding law could be even more pronounced for a government contractor with low profit margins, potentially threatening their operations through a tightening of its cash flow.

Our members have also heard from clients that the withholding law will likely have a negative impact from a Medicare payment perspective. Over the last decade the operating costs of medical service professionals, such as physicians, nurses, medical support staff, and administrators, have increased significantly while Medicare payments have only been increasing slightly in excess of 1 percent per year on average. With the additional prospects of further tightening in Medicare payments to medical providers in the coming years, the 3 percent withholding law may only exacerbate the cash flow problems facing medical professionals. We emphasize this point, particularly since we are not aware of any data suggesting that medical professionals (in general) are a compliance risk with respect to their payment of federal income taxes, considered the fundamental reason for imposing a withholding regime.

The 3 percent withholding law will notably alter the cash support accorded to efforts of American farmers. Farmers will be subject to 3 percent withholding because they receive certain payments through the U.S. Department of Agriculture. Under Internal Revenue Code section 6654(i), acknowledging the importance of cash employed in targeted activities, individual farmers and individual fishermen are required only to make one estimated tax payment as opposed to quarterly estimated payments; and such individuals are not required to make that one estimated payment until January of the following year. Also, that individual is not required to make an estimated payment if the taxpayer files his or her return by March 1. Imposition of 3 percent withholding on such farmers and fishermen will result in an acceleration of the tax payments to the government, something that would be in contradiction to the underlying policy reasons for enactment of section 6654(i). For the remaining taxpayers contracting with the government, the 3% withholding will unnecessarily complicate calculations of their estimated tax obligations.

In conclusion, the AICPA commends the subcommittee for holding today's hearing on the 3 percent withholding provision. We welcome the opportunity to discuss our views with you informally or at any future public hearing.

* * * * *

The AICPA (www.aicpa.org), founded in 1887, is the national professional organization of certified public accountants comprised of approximately 370,000 members in 128 countries. Our

members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, tax-exempt organizations, small and medium-sized businesses, as well as America's largest businesses.

STATEMENT
From

American Health Care Association

To The

House Committee on Small Business Subcommittee on Contracting and Workforce
Hearing On

“Defer No More: The Need to Repeal the 3% Withholding Provision”

May 26, 2011

The American Health Care Association thanks Chairman Mick Mulvaney and the members of the House Small Business Committee's Subcommittee on Contracting and Workforce for holding today's hearing examining the impact of the withholding mandate required in Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222). On behalf of the profession responsible for caring for our nation's most vulnerable citizens, the American Health Care Association (AHCA) is grateful for the opportunity to highlight the detrimental impact this withholding requirement will have on long term care facilities, as well as the frail, elderly and disabled in their care.

AHCA is a non-profit federation of affiliated state health organizations, together representing more than 11,000 non-profit and for-profit nursing, assisted living, developmentally-disabled, and sub-acute care providers that care for approximately one million elderly and disabled individuals each day. AHCA advocates for quality care and services for frail, elderly, and disabled Americans.

The *Tax Reconciliation Act of 2005*, which was signed into law in May 2006 (P. L.109-222), requires a tax withholding at a rate of three percent on all government payments for products and services made by the federal government, state governments, and local governments. In general, vendors that receive a payment which is \$10,000 or more from federal or state agencies will have three percent of that payment withheld. This withholding requirement impacts payments under government contracts, as well as Medicare payments.

While AHCA is pleased that the Internal Revenue Service (IRS) issued the final rule on the withholding mandate on May 9, 2011, which included a delay in implementation to January 1, 2013, this delay only postponed the inevitable impact that the mandate will have on the cash flow of long term care facilities that are dependent on Medicare payments.

AHCA is also one of more than 100 members of the Government Withholding Relief Coalition (GWRC) advocating for the repeal of the three percent tax withholding mandate. The GWRC was formed after the passage of the tax reconciliation bill by organizations concerned about the harmful and disruptive effects of this provision. AHCA wholeheartedly supports statements made to this Subcommittee by the GWRC and its members and wishes to highlight the unique impact that this mandate will have on long term care.

3% Withholding will have a significant impact on the America's elderly and disabled

The American Health Care Association is deeply concerned about the impact this requirement will have on facilities receiving government funds in exchange for their services. While supporters argue that imposing withholdings on payments made by federal, state and local governments will improve taxpayer compliance and reduce the tax gap, this is a withholding on all payments with no relationship to a company's tax liability and does not take into account the true ramifications of the requirement. The three percent withholding requirement may represent a means for finding tax delinquents; however, it hurts honest, taxpaying businesses which are required to provide the federal government what amounts to an interest-free loan.

The withholding mandate particularly does not take into account the unique nature of government payments under the Medicare program. There is no set annual contract payment amount that a long term care facility will receive from Medicare. Unlike other the goods and services paid for under government contracts, the federal government's total Medicare payments made to tax-paying long term care facilities depend on the volume of actual claims filed with the Centers for Medicare & Medicaid Services (CMS) which cannot be specifically determined before a tax year begins.

AHCA has estimated, based on prior Part A and Part B expenditure totals, that under this three percent withholding mandate approximately \$885 million could be withheld from Medicare payments to nursing facilities on an annual basis.¹ This withholding amount, while already significant in its impact, does not reflect the heavy administrative burden caused by accounting for these withheld payments. A long term care facility will have to expend extra time and money on tracking what it is owed in withheld Medicare payments by the government in order to later confirm the receipt of the funds that the facility is due.

While AHCA understands that these funds will eventually be returned by the IRS, the withholding of these vital Medicare payments upfront will seriously jeopardize long term care facilities' ongoing quality improvement efforts because operating margins for the taxable year would be driven even lower. These funds are crucial, particularly for the over 10,000 long term care companies that own one to three facilities and are truly considered small businesses with limited access to capital. Skilled nursing facilities already have the lowest operating margins of all major health care provider providers.

Approximately 3.2 million Americans – both older Americans and individuals with disabilities – received skilled nursing and rehabilitative care in one of nearly 16,000 skilled nursing facilities (SNFs) nationwide in 2008. Approximately 1.9 million of those cared for were Medicare beneficiaries. In fact, more than 50 percent of all Medicare beneficiaries needing post-acute care are discharged from an acute care hospital to a SNF. In addition, the long term care sector is a major driver of the U.S. economy, contributing to the employment of more than 5.4 million individuals

¹ Part A – CY2009 : \$28.0 billion; Part B – CY2008 1.5 billion; Total \$29.5 billion. 3% of \$29.5 billion is \$885 million.

nationwide, supporting more than \$205 billion in labor income and generating \$60 billion in both state and federal tax revenues.

Unless this three percent withholding mandate is repealed before the January 1, 2013, effective date, America's long term care facilities that depend on Medicare will lose access to vital funds, which are crucial in managing the daily activities and day-to-day operations that are necessary to ensure America's seniors and individuals with disabilities receive the quality long term and post-acute care that they need and deserve.

Again, we thank the Subcommittee on Contracting and Workforce for examining this important issue today. AHCA urges this Subcommittee to consider the impact of this law and the unintended consequences that such a mandate will have on those who provide services to our nation's most vulnerable citizens.

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STATEMENT BY:

MR. PATRICK NIXON

PRESIDENT – AMERICAN LOGISTICS ASSOCIATION

**BEFORE THE SUBCOMMITTEE ON CONTRACTING AND
WORKFORCE**

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

May 26, 2011

NOT FOR PUBLICATION

UNTIL RELEASED BY

THE HOUSE COMMITTEE ON SMALL BUSINESS

The American Logistics Association (ALA) for 90 years has sought to promote, protect and enhance the military resale and quality of life benefits on behalf of our members and the military community. The ALA is proud to represent 250 of America's leading manufacturers, numerous brokers and distributors, service companies, media outlets and more than 1400 individual members who are actively engaged in providing goods and services to our resale customers, MWR activities for our military, Coast Guard, and Veterans.

We appreciate the Subcommittee's interest in the issue and our opportunity to present our views. The military resale system provides a non-pay compensation benefit to military families to help their hard-earned dollars go farther by offering name brand products for sale at a discount. The commissary system, for instance, sells grocery and household products at cost, providing a significant savings of over 30% to military families. The exchanges operate on a profit basis where the sales of the products must pay for the day-to-day operations of the systems while creating a dividend that supports quality of life programs. The exchanges provide a nearly 20 percent savings benefit to military families operating in this fashion. Many other on-base businesses operated by the morale, welfare and recreation programs of the branches of the Armed Services also provide valuable services and discounts to our military people.

Implementation of this Act will place an extraordinary burden on military families. When implemented, additional costs will be incurred by the military resale systems as well as the manufacturers of the products in order to comply with Section 511. These costs will, in turn, have to be passed on to the military families at a time they can least afford it, reducing the value and quality of the benefit that is so important to military families. Consider that, since 2007, food stamp usage has *tripled* in the commissaries from \$24.9 million to \$73 million. In 2011, pay raises for military families will only be 1.4% so we estimate that more military families will join the ranks of those using food stamps.

The House Armed Services Committee recognized the burden that this measure will place on military families and in the May 17, 2011 report accompanying the H.R. 1540, The National Defense Authorization Act for Fiscal Year 2012, the Committee said: “The committee recognizes that the members of the Armed Forces and their families endure many financial hardships as a result of the intense operations tempo required to support ongoing military operations in the Republic of Iraq and the Islamic Republic of Afghanistan.” “The Committee believes that one of the most important benefits military families receive is the savings provided by the Defense Commissary Agency (DeCA) the military exchanges and other nonappropriated fund instrumentalities of the Armed Forces.” “The Committee understands that one of the major consequences of the

implementation of the Tax Increase Prevention and Reconciliation Act of 2005 will be higher prices that manufacturers will charge for goods sold to all nonappropriated fund instrumentalities of the Armed Forces to help offset the 3-percent withholding tax.”

Implementing existing law withholding 3 percent of all Government purchases will be extraordinarily costly for businesses and governments. The Department of Defense estimated that it would cost over \$17 billion in the first five years to comply with the three percent withholding requirement, which far exceeds any estimated revenue gains. This is only a small portion of the compliance costs with which government and the private sector would be burdened as a result of implementing this mandate.

The existing law will have a significant detrimental effect on the quality of life of military personnel and their families. The legislation, if allowed to be implemented will severely impact cash flow of businesses that provide goods and services to military commissaries, exchanges and morale, welfare and recreation (MWR) programs, particularly small businesses which are least likely to be able to absorb it. The result could be increases in prices to service men and women as businesses are forced to pass along the compliance costs to military resale programs. The legislation could also result in discouraging companies from

participating in the military resale business, reducing competition and impacting pricing.

Moreover, military commissaries, exchanges and MWR programs resale entities would have to dip into already tight budgets to reprogram financial management systems to keep track of the 3 percent tax. Because Congress provided no money to implement the change, agencies will have to absorb the cost, use increased appropriations, or pass this cost along to military families.

In particular, because the withholding is a flat percentage of revenues from government payments, it bears no relationship to companies' taxable incomes and it will restrict cash flow needed for day-to-day operations. In addition, the administrative and capital investment costs to businesses and government will be substantial and the withholding mandate will be exceedingly complicated to implement.

For military commissaries and exchanges, the 3 percent withholding will require all accounting and procurement systems, contracts, and procedures to be modified to accommodate this withholding. These accounting and procurement are funded with military service member dollars. These modifications will cost the NAFIs significant amounts of military Service members' dollars. The cost to

DeCA, funded from appropriations used to operate commissary stores, will result in less funding available for service to military patrons.

Also, this Act will place an onerous burden on the many small businesses that deal with DeCA and the military nonappropriated fund instrumentalities (NAFIs). These businesses will most likely pass the burden on to DeCA and the NAFIs resulting in higher prices to our military Service members. Many of the small businesses will choose not to deal with DeCA and the military NAFIs due to this provision.

We respectfully request repeal of this requirement and support of H.R. 674 and look forward to your support.



STATEMENT

of the

American Medical Association

for the Record

**House Committee on Small Business
Subcommittee on Contracting and Workforce**

**Re: Defer No More:
The Need to Repeal the 3% Withholding Provision**

May 26, 2011

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STATEMENT

of the

American Medical Association

for the Record

**House Committee on Small Business
Subcommittee on Contracting and Workforce**

**Re: Defer No More:
The Need to Repeal the 3% Withholding Provision**

May 26, 2011

The American Medical Association (AMA) appreciates the opportunity to provide our views on section 511 of the Tax Prevention and Reconciliation Act of 2005 (TIPRA), Pub. L. No. 109-222, 26 U.S.C. 3402(t). Under this provision, federal, state and local government entities are required to withhold 3 percent of all payments made for services or property after December 31, 2011, including payments under the Medicare program. The AMA lauds the leadership of the Subcommittee for addressing this important matter.

The AMA strongly opposes section 511 and we support repeal of this provision. There was no opportunity for Congress or affected parties to appropriately discuss the policy implications of this provision since it was inserted into the TIPRA conference report, and was not included in the House or Senate version of the tax legislation. This requirement will be extraordinarily costly and administratively burdensome to implement, and government agencies, physicians, and other health providers will all bear the brunt of these costs and administrative burdens, which will far outweigh any possible benefit of the withholding requirement.

For the reasons discussed below, the AMA strongly opposes section 511 and urges that this provision be repealed, or in the alternative, we strongly support an exemption from section 511 for physicians and all providers who furnish health care services to Medicare beneficiaries and enrollees of other federal health care programs, including, for example, TRICARE, the Federal Employees Health Benefit Program (FEHBP), and the Veterans Administration.

The Withhold Provision Will Place a Significant Burden on Medicare and Further Jeopardize Access to Care for Medicare Beneficiaries and Military Families

The Centers for Medicare and Medicaid Services (CMS) announced that total Medicare spending in 2010 was \$523 billion. Section 511 may apply to a large portion of this total outlay. This will require the application of significant resources by the Medicare program, as well as by physicians and other providers, to administer and ensure proper operation of this provision.

The vast majority of physician practices are small businesses. According to the AMA Physician Practice Information Survey, 78 percent of office-based physicians in the United States are in practices of nine physicians and under, with the majority of those physicians being in either solo practice or in practices of between 2 and 4 physicians. Withholding 3 percent of Medicare payments for services furnished by physician practices will create a difficult cash flow problem for physician practices as small businesses. This will be extremely detrimental to Medicare beneficiaries and the physicians who treat them because the withhold comes on top of drastic cuts in Medicare physician payment rates projected in the coming decade. Under current law, in the absence of Congressional action, Medicare physician payment rates are scheduled to be cut by 29.5 percent on January 1, 2012, with cuts potentially continuing in future years. These successive annual reductions are due to a statutory formula called the sustainable growth rate, or SGR. It governs annual Medicare physician payment updates and is broken beyond repair and must be replaced.

Cuts of this magnitude, on top of physician payment rates that, to date, have fallen well behind medical practice cost inflation, will impact access to care for our nation's seniors, those with disabilities, and the baby boomers now entering Medicare.

In a 2010 AMA survey, about one in five physicians overall, and nearly one-third of primary care physicians, say they are being forced to limit the number of Medicare patients in their practice due to the ongoing threat of future physician payment cuts and inadequate Medicare rates.

It is clear that physicians cannot absorb the pending cuts in Medicare physician payment rates, and the resultant pending access crisis for Medicare beneficiaries will only be made worse if physicians face serious cash flow interruptions due to the 3 percent withhold, on top of steep cuts projected for 2011 and beyond.

Medicare beneficiaries will not be the only vulnerable population affected by these cuts. The Military Officers Association of America states that Medicare physician pay cuts would significantly damage military beneficiaries' access to care under TRICARE, as TRICARE payments are linked to Medicare rates. Further, the congressionally-created Council on Graduate Medical Education is already predicting a shortage of 85,000 physicians by 2020. Medicare cuts will exacerbate this shortage by making medicine a less attractive career. Section 511 will only hasten these trends and disproportionately impact physician specialties that treat a higher percentage of Medicare patients, thus further driving looming shortages in these particular specialties. This will adversely impact the delivery of health care to all patients in this country.

Other government contractors have the ability to, and will, increase contract bids to account for the 3 percent withhold. This unfairly and disproportionately places a burden on physicians who participate in the Medicare program because their payment formula establishes specific payment amounts for each medical service furnished under the program. Therefore, unlike other government contractors, physicians cannot increase amounts owed to them by Medicare.

The Implementing Costs of the Withhold Provision Greatly Outweigh Any Benefit to the Federal Government

The section 511 withhold is intended to offset otherwise unreported tax revenues, and although it \$7 billion revenue score when enacted, the vast majority of these dollars results from an initial acceleration of tax receipts and not from an actual revenue increase from improved tax compliance. We understand, rather, that the provision was estimated to result in only about an estimated \$215 million per year of increased revenue (with only slight increases in each of the following years). These amounts will not likely offset the government and private sector costs that will be required to implement section 511. Government and private sector systems, including physician group practices and solo practitioners, are not set up to track and ensure the appropriateness of the withhold. This will become particularly difficult to administer as the 3 percent withhold amount may need to be retroactively tracked and adjusted if, for example, a physician successfully appeals a claim or files a corrected claim and the payment amount for such claim is subsequently adjusted by the Medicare contractor.

This tracking and recordkeeping system will be complicated by the fact that most physicians and other providers receive payments from many different government organizations, each of which will apply the 3 percent withhold, thereby significantly complicating the record-keeping and reconciliation processes. A single physician practice, for example, may provide services to patients enrolled in many different federal programs, including Medicare fee-for-service, the FEHBP, the Veterans Administration, TRICARE, or a state, county, or city health plan. Physician practices likely would be notified of the withheld amounts in the remittance advice accompanying the federal payment for the medical services provided. They also likely would receive periodic reports from each of the withholding organizations to show how much was withheld by taxpayer identification number. The physician practice would then need to reconcile the remittance advice with the periodic reports.

The substantial administrative costs, required oversight, and hassle factor related to implementation of section 511 will far outweigh any benefit from this provision. Existing laws provide the government with the authority to force companies to pay their tax liabilities, and greater benefit could come from better enforcement of these laws rather than requiring a withhold on tax-compliant physician practices and companies.

The Federal Payment Levy Program (FPLP), for example, provides a simpler, more targeted, and equitable means for addressing healthcare providers who fail to pay their federal taxes. Under the FPLP, CMS may reduce Medicare payments subject to the levy by 15 percent of the payment, and the levy is continuous until the overdue taxes are paid in full or other arrangements are made to satisfy the debt. The advantages of this targeted approach are far superior to the across-the-board withholding policy that will impose a significant

administrative and financial burden on physicians and all other tax-paying health care providers, along with all affected government units as well.

Due to the overall administrative costs (which far outweigh any benefit of section 511), the threat to access to medical care for Medicare beneficiaries and military families, and the burden section 511 would place on numerous government agencies, the Medicare program, physicians, and other Medicare providers, the AMA urges the Subcommittee and Congress to repeal section 511 this year.

We appreciate the Subcommittee's critical role in reviewing this costly and burdensome withhold provision, and look forward to working with the Subcommittee and Congress to repeal this provision before its January 1, 2012 effective date.

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Before the
United States House of Representatives
Small Business Committee
Subcommittee on Contracting and Workforce

Statement of the
American Trucking Associations, Inc.
On the
Need to Repeal the 3% Withholding Provision

26 May 2011



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Contact: **Bill Wanamaker**
Director, Government Traffic & Security Operations

The American Trucking Associations (ATA) appreciates the opportunity to submit comments to the Subcommittee on Contracting and Workforce in support of repealing the 3% withholding tax. Specifically, Section 511 of the *Tax Increase Prevention and Reconciliation Act of 2005* (PL 109-222) created more than just a new tax; it mandates new layers of bureaucracies in municipalities, states and federal agencies, to collect the new tax. As a result, it will cost far more to implement than it will raise in new federal revenues. Stakeholders include agencies in every level of government, every industry that supplies goods and services to those myriad agencies, and the American taxpayer. The bottom line is this: by repealing this provision, Congress will save money at every level of government from the municipal to the federal level.

Repeal of this provision will eliminate a burdensome and costly requirement for the trucking industry, an industry that is comprised primarily of small businesses. The United States Department of Transportation reports¹ having issued “for hire” motor carrier authority to 370,082 companies. Approximately 90 percent of those companies operate six or fewer trucks, and 97% operate twenty or fewer trucks,² making small businesses the cornerstone of the trucking industry and squarely in the domain of this body. ATA commends the Subcommittee for holding this hearing and we strongly support repealing Sec. 511.

ATA is a member of the Government Withholding Relief Coalition. ATA supports and affirms the Coalition’s comments regarding the repeal of Sec. 511.

The trucking industry is a critical component of our nation’s economy, generating more than 80 percent of our country’s freight bill and transporting approximately 69 percent of all tonnage moved in the United States. More than 80 percent of communities in the United States depend solely on trucks to receive their everyday essential consumer goods. Not only are private sector consumers dependent on trucks to deliver and ship their goods, but so are public entities at the federal, state and local government level. Because of this, once the 3% withholding tax becomes effective, the administrative and cash flow burdens it imposes on every motor carrier providing government services will likely result in higher costs for transportation of the freight that sustains their operations.

Motor carriers participating in ATA’s Government Traffic Policy Committee voted unanimously to seek repeal of Sec. 511. ATA members, including those who provide services to federal agencies, not only transport commodities essential to our everyday life such as fuel and food, but also transport relief goods to storm ravaged areas, as well as uniforms, munitions, rockets, bombs, armored vehicles, and all other sustainment items that allow our men and women in uniform to defend and protect our nation. If Sec. 511 is not repealed, the additional costs resulting from this section will be passed on to the government consumer through higher prices. This will impact all government agencies, from local municipalities to the U.S. Department of Defense (DoD), and result in higher prices on everything from pencils and paper to munitions and meals.

¹ As of December 2010.

² United States Department of Transportation; Federal Motor Carrier Safety Administration

A recent initiative within DoD for procuring freight services is to shift from a tender-based procurement method to a contract-based system under the Federal Acquisition Regulations (FARs). This trend, combined with the 3% withholding provision, means that many more trucking services (or “shipments”) currently priced at less than the \$10,000 threshold will be bundled to exceed that threshold, and thereby become subject to the 3% withholding. ATA opposes both of these initiatives because each one on their own merits adds unnecessary costs without adding any performance advantage whatsoever to the government agencies served. The resulting increased costs will be ultimately passed on to taxpayers without any real benefit in improved services.

One of the most troubling aspects of Sec.511 is that the Internal Revenue Service final rule³ specifies that the withholding will also apply to fuel surcharges (FSC). A FSC is a charge that a carrier may add to a shipper’s bill depending on the cost of fuel at the time the service was provided. Some shippers, including government agency shippers, require carriers to commit to a fixed rate for a specific freight service; the period of that commitment may last up to a year or more. Fuel is always the number one or two highest cost component for trucking companies. Its inherent market volatility makes it impossible for a carrier to know what the cost of fuel will be 30 days hence. For this reason, rates that are binding for more than 30 days typically include a FSC. If a FSC is not included in such contracts, the carrier faces an untenable level of risk due to higher diesel costs resulting in a potential financial loss to the carrier. Thus, a FSC is nothing more than a cost recovery mechanism that allows carriers to offer their lowest competitive rates to shippers, including government shippers, beyond 30 days.

Government FSC rates are generally lower than FSCs paid between private parties. If those cost recovery payments are reduced by yet another 3%, then the base rates will need to be raised by more than 3% because it is impossible to know by how much the cost of diesel will exceed the baseline amount assumed in the base rate (tender). The 3% withholding provision unravels the long tradition and best practice in both industry and government to implement reasonable cost recovery through the FSC. Given the volatility of markets, the economy and diesel prices in particular, it is our view that a carrier that wants to be financially solvent beyond the period specified in a government contract will estimate fuel costs on the high side to protect themselves against default of performance, if the current price of diesel exceeds the fuel cost assumption in the basic contract rate. This is a classic case of government policy inducing costly uncertainties and speculation into market decisions between shippers and carriers.

There are no winners if the 3% withholding goes into effect. Congress needs to repeal the requirement as soon as possible, before trucking, other industries, and government make the very expensive changes to their accounting, billing computer programs, and contracting systems needed to comply with the new withholding requirement. If Congress waits until the last minute, those very large expenditures will result in an enormous waste of money, by governments and employers, that none can afford. ATA strongly encourages Congress to repeal Sec. 511 as soon as possible.

³ IRS draft final rule. Summary of Comments and explanation. Paragraph “F”



Statement of Associated Builders and Contractors

House Small Business Committee

Subcommittee on Contracting & Workforce

Chairman Mick Mulvaney and Ranking Member Judy Chu

"Defer No More: The Need to Repeal the 3% Withholding Provision"

May 26, 2011

The Voice of the Merit Shop

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Associated Builders and Contractors (ABC) appreciates the opportunity to submit the following statement for the official record. We would like to thank Chairman Mick Mulvaney, Ranking Member Judy Chu and members of the Subcommittee on Contracting and Workforce for holding today's hearing, "Defer No More: The Need to Repeal the 3% Withholding Provision," which will examine Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

ABC is a national trade association with 75 chapters representing more than 23,000 merit shop construction and construction-related firms with nearly two million employees. Our diverse membership is bound by a shared commitment to the merit shop philosophy in the construction industry. This philosophy is based on the principles of full and open competition unfettered by the government, nondiscrimination based on labor affiliation, and the award of construction contracts to the lowest responsible bidder through open and competitive bidding. This process assures that taxpayers and consumers will receive the most for their construction dollar.

Today's hearing will focus on the withholdings on payments remitted by governmental entities as proposed in Section 511 of TIPRA and now included in Internal Revenue Code (IRC) 3402(t) for payments remitted after December 31, 2012. Should IRC 3402(t) be implemented, there will be a dramatic negative effect on the economic viability of the construction industry in the United States. Consider:

- These withholdings on payments will dramatically impact the cash flow of the Construction Industry and increase the cost of construction for governmental projects;
- Secondly, costly over-regulation will be the result of this new law – and these increases in the end will be borne by taxpayers; and
- Thirdly, there are alternatives to the required withholding that can be implemented in lieu of the withholding requirements under IRC 3402(t).

We now consider these three points in order.

1. Cash Flow Impact to the Construction Industry

According to statistics accumulated in *Construction Industry Annual Financial Surveys* published by Construction Financial Management Association, the construction industry operates with a very low net margin. One recent survey reported the average construction company's operating margin is 2.2. This 2.2% is a composite so some companies participating in the survey may generate a larger profit and others less profit.

The industry has been historically known for low net income margins and the implementation of IRC 3402(t) will negatively impact this already cash-tight industry. Construction is an industry in which businesses unfortunately fail and in many such cases it is because of inadequate capitalization. A reduction of cash flow will further stymie the economic viability of contractors performing work for the governmental entities who do not always have adequate cash flow and equity. While we certainly do not believe it is the intent

of Congress to cause small businesses to go out of business that may be an unintended effect of IRC 1302(t).

Contractors utilize Surety credit to secure certain contracts, as is the case with many governmental jobs. Typically, only financially qualified contractors can secure surety bonds. Significantly, a prerequisite considered by sureties in extending surety capacity to contractors is adequate working capital. Adequate working capital reflects adequate cash flow. This provision under IRC 3402(t), if implemented, will have a negative impact on cash flow and hence, could reduce the number of contractors that can qualify for adequate surety capacity to work on jobs for governmental entities. The result would, in turn, mean less competition for governmental jobs, and therefore more cost to taxpayers. While we certainly do not believe it is the intent of Congress to reduce competition on governmental construction projects that may be an unintended effect of IRC 3402(t).

Exhibit A reflects a typical example of a contractor who has a \$10 million contract and faces 10% retainage (cash hold-backs) on that job. As a result, there will be roughly 13% withheld from the cash flow of the job when the 3% federal withholdings under IRC 3402(t) is added to standard retainage. The chart in Exhibit A has been produced to reflect how payments are remitted on a typical construction contract. The net result for this sample contract is a 30% reduction of actual cash flow to the contractor. At certain points, the contractor will actually be at a deficit until the final payment is received on the job. Restated: the contractor will experience no profit but a cash loss on the job until he receives final payment on the job.

This simple example shows the dramatic impact of removing what appears to be a small percentage of the gross revenue on a job. The important point is that the 3% withholding required under IRC 3402(t) is based on gross payments, not net. It is conceivable that a contractor, not fully understanding the implications of this 3% withholding could cause himself to not produce any profit in cash on the job whatsoever. All of the profit could be subjected to withholdings that the contractor will not receive the benefits of until the filing of an annual tax return. This could be, in many circumstances, as much as a year later.

Consider that the knowledgeable contractor facing this mandatory 3% withholding on government contract payments would include in their bid an estimated cost of capital to fund this additional burden to their working capital (cash flow). While we certainly do not believe it is the intent of Congress to cause higher prices to governmental entities for construction services this may be an unintended effect of IRC 3402(t). Restated: this would be a further tax on taxpayers in the sense that this withholding requirement will increase the cost of construction of public facilities and services.

2. Hidden Costs of Regulation

There will be costs to implementing IRC 3402(t) for the jurisdictions that are required to withhold taxes. In addition to upfront information technology costs, there will be ongoing annual costs. In the aggregate, for all jurisdictions across the country as well as the federal government, this will be a significant amount of money that impacts the entire economy and all governmental entities. Compliance for the Defense Department alone will cost over \$17

billion over five years based on an impact assessment ordered by the House Armed Services Committee¹. According to one private sector study the direct cost of implementation to governments will amount to as much as \$75.2 billion over the first five years. These additional costs will need to come from somewhere and this will only mean additional budget constraints and potentially additional taxes at state and local levels.

Additionally, each of the jurisdictions will have to effectively communicate the requirements of IRC 3402(t) to all of their payees and services providers. This will have an impact to bidding documents, which will likely require additional legal fees for review. Further, consider the changes to “advertisements to bid” and information displayed on governmental websites. In the aggregate, although we don’t have any firm estimates today, it is fair to say that this will be a significant amount of money that puts into question the true annual aggregate impact for taxpayers and the federal government.

Billing practices will also have to change. This will affect documentation that has been traditionally utilized by governmental agencies and their service providers, such as construction contractors. As indicated previously, not only will it affect bidding documents, but also consider how it will affect standard contracts that are issued by jurisdictions across the country. This will entail additional legal fees and opportunity costs for internal review.

Another complication that will impact contractors is how they will comfortably address their estimated taxes. Depending on the timing and amount of payments received on their governmental contracts, contractors may have significant cash withholdings that they cannot utilize or “get to” until they file a tax return. If, for example, a contractor is having a less profitable tax year, they may have a significant amount of withholdings and very little, or no corresponding tax.

Consider if a contractor has a net operating loss. In addition to a refund of all taxes for the current year, the contractor is in a position of also potentially filing for a carry-back claim refund. The result could be a significant amount of withholdings that would be far better served in the hands of the contractors. This common circumstance has little to do with the so-called “tax gap” and appears more to do with the federal government implementing what amounts to a hidden tax increase to the compliant taxpayer. IRS regulations indicate there will not be an exemption for taxpayers with zero liability.

In any event, if withholdings do occur, how are the internal and outside accountants to facilitate any certainty of what tax withholdings will, in fact, be available for estimated tax purposes? This would require specific advanced knowledge of when and how much the final payment would be from the governmental entity by the end of the calendar or fiscal year of the contractor. If the contractor has multiple governmental entity jobs, it will be unduly burdensome to estimate how much withholdings will be available for the tax return that will be filed, either two and a half or three and a half months later after the end of the fiscal year (i.e. March or April 15th for the calendar year taxpayer).

¹ Office of the Under Secretary of Defense for Acquisition, Technology & Logistics. *DOD Report on the Impact of Compliance With Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005*. Rep. 2008. Print.

Another issue for cash flow and estimated tax purposes is how will withholdings be handled for pass-through entities such as S Corporations and limited liability companies? Section 1402(t) indicates that the payments will be withheld from the person providing any property or services. However, the entity that is providing the property with services may not be a taxpaying entity. For a pass-through entity that has multiple pass-through beneficiaries (i.e. S Corporation shareholders or LLC members) this will add another layer of confusion and burden. Significant cash flow could be withheld and the corresponding benefit of those prepayments may be for an entity that doesn't even have a tax liability. More than five years after the passage law, the IRS still has no answer as to how pass-through entities will handle the withholding under Section 511.

3. Alternatives to Withholdings

We recognize that this law was passed with good intent. The objective appears to be mitigation of the so called "tax gap". However, we believe this law has unintended effects that have not been fully considered, and as indicated above, the cost, uncertainty, and cash flow impact to the construction industry is untenable.

IRS statistics indicate that when reporting requirements such as Forms 1099 are required, compliance increases from approximately 57% to 96%.² IRS statistics also indicate that when reporting requirements are elevated to actual withholding requirements, which in the instant case are both withholding and reporting requirements simultaneously, the elevation in compliance is elevated from 96% to 99%.³ As you can see from the Internal Revenue Service's statistics, taking the extra step of requiring withholdings rather than taking the simple step of moving from no reporting to requiring information reporting, there is only a three percent *estimated* increase in the compliance rates.

The implications of this is that if Congress were to simply implement reporting requirements on certain payments remitted by governmental entities, rather than extending withholdings to the payments remitted by governmental entities, a significant level of compliance will still be increased. While this would still entail significant, and in some cases untenable administrative and other costs, this would be a better step than removing cash flow from a cash-strapped construction industry. Most importantly, this would remove many of the cash flow concerns raised above. As indicated, the cash flow concerns of the construction industry are significant because:

- a. It impacts the ability of a contractor to manage their operations work because they need adequate working capital (cash flow) to fund their operations;

² *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006).

³ *The Causes and Solutions to the Federal Tax Gap: Hearing Before the Senate Committee on the Budget, 109th Cong. (2006)* (written statement of Nina E. Olson, National Taxpayer Advocate available at: <http://budget.senate.gov/repUBLICan/hearingarchive/testimonies/2006/NinaOlsenTestimony.pdf>)

- b. It further impacts the ability of a contractor to secure work because they need adequate working capital (cash flow) to qualify for surety credit;
- c. The contractor, like all small businesses, needs to ensure at the earliest opportunity, they actually receive the profit that they do earn on the contracts rather than waiting for an annual tax return to be filed at some date in the future.

4. Conclusion

ABC commends you for holding today's hearing to discuss repealing the 3% withholding provision. We respectfully request that the preceding is carefully considered and should any other comments be necessary or desired, please contact us for additional information. We look forward to working with the Subcommittee in reaching a feasible solution that is agreeable for all concerned constituencies including the construction industry.

Again, ABC thanks the Chairman, Ranking Member and members of the Subcommittee for the opportunity to present the views of our membership on this important issue.

Respectfully Submitted,

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Word CPA Group, P.A.
Chair, ABC National Tax Advisory Group

Rich Shavell, CPA, CCIFP
President, Shavell & Company, P.A.
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June 2, 2011

House Small Business Committee
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Statement for the Record
The Coalition for Government Procurement
Before the House Committee on Small Business, Subcommittee on
Contracting and Workforce
To Amend the Internal Revenue Code of 1986 to Repeal the Imposition
of 3 Percent Withholding on Certain Payments Made to Vendors by
Governing Entities,
H.R. 674

Mr. Chairman and Members of the Subcommittee.

The Coalition for Government Procurement ("Coalition") appreciates the opportunity to comment in support of H.R. 674 and the repeal of the tax withholding requirement of Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. The Coalition commends the Subcommittee on Contracting and Workforce for holding a hearing on this important issue.

The Coalition for Government Procurement is a non-profit association of approximately 300 firms selling commercial services and products to the Federal Government. Coalition members include small, medium and large business concerns, all of which in most contexts would be subject to the withholding. The Coalition is proud to have worked with government officials over the past 30 years towards the mutual goal of common sense acquisition. Moreover, our common sense approach has led us to join a united effort as a member of The Government Withholding Relief Coalition. In addition to comments from The Government Withholding Relief Coalition, we would like to reemphasize a couple of key points.

Section 511 requires a 3% tax withholding on all government payments for goods and services made by federal, state, and local governments with annual expenditures of \$100 million or more for payments of \$10,000 or greater. The final IRS rule, states that contracts

awarded after December 31, 2012 will be subject to the withholding, 26 C.F.R. § 31.3402(t) (2011). The withholding represents vital financing for contract payments, Medicare payments, farm payments, and certain grants. Additionally, the IRS has made notice of a proposed rule that the 3% withholding should be subject to all contracts beginning January 1, 2014, which will include contracts entered into before the enactment of the law.

Compliance with the 3% withholding will unduly burden both the public and private sectors, as both sectors will have to make significant changes to their financial systems. Given the sweeping scope of the law covering both government and industry, implementation costs will substantially outweigh any possible savings.

An example of the potential for a broad detrimental impact is illustrated by a 2008 Department of Defense (“DoD”) report. DoD has estimated costs of administration to be \$17 Billion over the first 5 years for that agency alone.¹ Although this number is less than originally expected, the DoD still anticipates the impact to be significant and in the billions of dollars. In addition to the impact on the DoD, the costs would be spread and multiplied to other civilian agencies, states, counties, cities, municipalities, as well as the contractor community.

The burdens of compliance will also harm the private sector. The 3% withholding will impact the cash flow of all business, but particularly small business as they often run on narrow margins of revenue. Their day to day operations will also be affected by the withholding. In addition, businesses will be forced to develop new internal systems to account for withholdings. The cost of implementing these accounting systems will be magnified for small businesses as they lack the resources to absorb the increasing costs of compliance.

The reduction in revenue and the increased costs negatively affects small, medium, and large businesses and in turn the overall health of the economy. The impact on the small businesses of America will be especially significant as they represent the great engine of our economy, as well as the main source of job creation.

It is vital that the repeal take place now. Merely delaying the implementation creates an environment of uncertainty and

¹ 2008 Department of Defense Report on the Impacts of Compliance with Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005.

unpredictability. The rule is already costing industry as prudent businesses are making investments in order to comply. This is a financial investment that could be going towards job creation rather than job destruction.

The Coalition supports H.R. 674 and appreciates the opportunity to comment. If you have any questions, I am available at (202) 315-1051 or rwaldron@thecgp.org.

Regards,

A handwritten signature in black ink, appearing to read 'RWaldron', with a long horizontal flourish extending to the right.

Roger Waldron
President

Steve Largent
President/CEO

CTIA
The Wireless Association®

Expanding the Wireless Frontier

May 25, 2011

The Honorable Sam Graves
Chairman
Small Business Committee
U.S. House of Representatives
2361 Rayburn Office Building
Washington, D.C. 20515

The Honorable Nydia Velazquez
Ranking Member
Small Business Committee
U.S. House of Representatives
2302 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Graves and Ranking Member Velazquez:

On behalf of CTIA – The Wireless Association® I commend the Small Business Subcommittee on Workforce and Contracting for holding a May 26, 2011 hearing on Rep. Wally Herger's legislation, H.R. 674 to repeal the 3% government withholding requirements enacted as part of P.L. 109-222, the *Tax Increase Prevention and Reconciliation Act of 2005*. These requirements are currently set to become effective on January 1, 2012 and would require any federal, state or local agency that purchases services from wireless providers to withhold 3% of those payments and credit the funds to the providers federal income tax account.

These provisions were enacted to increase tax compliance, and more specifically to ensure tax payments, from companies doing business with governmental entities. While CTIA strongly believes that any entity providing goods and services to the government should comply with all federal, state and local tax requirements, these requirements will impose significant administrative and costly financial burdens on both the public and private sector. Specifically, for those entities that already comply with all tax laws and yet they will still be required to incur significant costs and ongoing administrative burdens to comply with the 3% withholding provisions. While these requirements do not take effect until 2012, companies, as well as federal, state and local governmental entities, are already expending significant funds to make the changes needed to their accounting and billing systems to ensure they will be ready to comply with these requirements.

On behalf of CTIA, thank you for holding a hearing on this important and much needed legislation to provide certainty and eliminate unnecessary costs for those that do business with governmental entities as we move closer to the 2012 effective date of these provisions. At a time when our economy is still very fragile, imposing significant costs and administrative burdens on both the public and private sector will hinder our country's continued economic recovery.

Sincerely,

Thanks for your help!

Steve
Steve Largent





The Computing Technology Industry Association

**Testimony Before the
Subcommittee on Contracting and Workforce
House Committee on Small Business**

3% Withholding Tax on Government Contracts

Thursday, May 26, 2011

Submitted by

Lamar Whitman,

CompTIA, Public Advocacy Director

Introduction.

Good afternoon, Chairman Mulvaney, Ranking Member Chu, and distinguished Members of the Committee. This testimony is submitted on behalf of the Computing Technology Industry Association, also known as CompTIA. CompTIA represents the interests of over 2,500 companies, many of whom are small IT businesses.

I want to thank Chairman Mulvaney and Members of the Committee for holding this important hearing concerning the effects of the impending 3% withholding requirement on certain government payments. While this requirement does not distinguish between government payments made to either large corporations or small unincorporated businesses, our comments today will concentrate on the effect of this provision on our small business members. We believe your efforts to focus public attention on this issue will lead to actions that will preserve tax compliance, without unfairly penalizing compliant small businesses.

Small businesses are the backbone of the American economy. According to the Small Business Administration Office of Advocacy, there are approximately 30 million small businesses in the United States, which represent over 99 percent of all employer firms and employ over half of all private sector employees. An even more important statistic for our membership is the fact that small businesses hire 40 percent of all high tech workers, many of whom are CompTIA members.

About CompTIA.

The Computing Technology Industry Association (CompTIA) is the voice of the world's \$3 trillion information technology industry. Members includes companies at the forefront of innovation and product development, along with the channel partners and solution providers they rely on to bring their products to market and the professionals responsible for maximizing the benefits that organizations receive from their technology investments. The promotion of policies that enhance growth and competition within the computing world is central to CompTIA's core functions. Further, CompTIA's mission is to facilitate the development of vendor-neutral standards in e-commerce, customer service, workforce development, and ICT (Information and Communications Technology) workforce certification.

The Issue.

We come here today to discuss the effects of a 3% federal withholding requirement on payments made by government entities. We believe this withholding requirement is unnecessary to promote tax compliance and will unfairly penalize compliant small businesses.

Enacted into law on May 17, 2006, section 511 of the “Tax Increase Prevention and Reconciliation Act of 2005” (Public Law No. 109-222) requires all federal, state and local government entities and instrumentalities to withhold 3% of payments made for goods and services for federal income tax liabilities. Originally set to go into effect in 2010, the effective date of this provision has been deferred to 2012.

First, we must note the unprecedented nature of this new withholding requirement. As a general rule, prepayments of tax (either withholding tax or estimated tax payments) historically have borne some direct relationship to a taxpayer’s estimated income tax liability for a specific tax period.

For individual taxpayers, a wage earner prepares a Form W-9, which determines the federal income tax that will be withheld from payments of wages and salary. Individuals with non-wage income and most businesses generally prepare an estimated income tax return calculating the estimated tax due according to the anticipated taxable income for the year. In both situations, the amount of tax required to be withheld or paid as an estimated tax is based on the expected tax liability for that particular taxable year.

However, this new 3% withholding requirement departs from the traditional scheme of federal tax payments, because the static 3% withholding rate bears no relation to anticipated taxable income. Indeed, a VAR working under a government contract with a slim profit margin could actually experience a net loss for the tax year; even so, that VAR would still be subject to the 3% withholding.

Cash Flow Examples.

With keen competition, VARs operate on very small profit margins – often three percent to six percent, and it is not unusual for margins to be as low as one to two percent. To illustrate the practical effects of this 3% withholding requirement, consider the following example of a company operating on a six percent net income margin:

Gross Sales	\$5,000,000
LESS: Cost of Sales	\$4,000,000
Gross Profit	\$1,000,000
LESS: Operating Expenses	\$ 700,000
Net Income	\$ 300,000
FIT Federal Income Tax	\$ 100,250
Income After Tax	\$ 199,750

Based on this example, the government would withhold \$150,000 from the \$5,000,000 (3% x \$5,000,000 = \$150,000) contract payment. However, the federal income tax liability is only \$100,250. Accordingly, this small business would be deprived of about

\$50,000 of operating capital that cannot be recouped until after the income tax return is filed for the year during which the withholding is made (generally due on March 15 following the close of the calendar tax year). This 3% withholding requirement becomes even more absurd when applied to a company with a four percent net income margin:

Gross Sales	\$5,000,000
LESS: Cost of Sales	\$4,000,000
Gross Profit	\$1,000,000
LESS: Operating Expenses	\$ 800,000
Net Income	\$ 200,000
FIT Federal Income Tax	\$ 61,250
Income After Tax	\$ 138,750

When the taxable income margin is reduced to four percent, the federal income tax drops to \$61,250, however the withholding remains unchanged at \$150,000. Thus, this small business would be deprived of almost \$90,000 in operating capital.

This 3% withholding provision has a regressive effect, reserving its greatest penalty for those businesses with the lowest net income – typically, small businesses. As such, this 3% withholding requirement is particularly burdensome for small businesses – and even more burdensome to small technology businesses, which already operate on thin net income margins.

Adverse Effects on Small Businesses.

Federal procurement opportunities will be reduced. As you know, the federal government has a small business contracting goal of 23% agency-wide. The subject 3% withholding requirement will certainly make this 23% goal more elusive for most government agencies, and within a few years we will see a decrease in economically doable government procurement opportunities for small businesses. As a result, this 3% withholding requirement will widen the procurement gap between small and large contractors, and out of necessity, the federal government will proceed to purchase an increasing proportion of goods and services from larger concerns, which have larger cash flows that can accommodate the 3% withholding.

Cash flow concerns for both prime and subcontractors. Even if a small business acts as a subcontractor to a large prime, the cash flow decrease resulting from the 3% tax withholding will inevitably be passed down from the prime to the small business subcontractor. Therefore, we believe the resulting cash flow for a small business contractor will be negatively affected, whether the small business itself acts as a prime or as a subcontractor to a larger prime.

Unfair result for more successful contractors. Those businesses earning a greater

percentage of revenues from government sales will be more adversely affected. Another way of saying this is: Those businesses that have worked to partner with and supply government purchasers with quality goods and services will be the group most penalized. We believe this is an unfair and unreasonable outcome.

Increased interest costs. Clearly, this 3% withholding will widen the competition gap between large and small businesses. It will become more difficult for small businesses to run their day-to-day operations, as the amounts withheld cannot be recouped until after the tax return is filed. In order to compete, smaller contractors will have to add interest costs (for operating funds needed to cover the 3% withholding amount) into their contract costs, and this will clearly affect their competitiveness. As such, we expect this 3% withholding will cause a shift in the composition of government suppliers away from small business (both in prime and subcontracting roles).

Higher contract costs for government. The increased interest costs for small businesses will force contractors to either renegotiate their pricing with the government or remove minimally profitable products from contracts. Clearly, this will decrease the availability of goods and services for government agencies. Also, the increased administration costs to the government and prime contractors (e.g., information collection, compilation, reconciling and reporting) will most certainly be passed down to the small business contractor.

Allocation issues. Many small businesses file either a subchapter S corporation or a partnership return. Accordingly, we must note the added complexity (and added compliance costs) the 3% withholding requirement brings to return preparation for these small businesses. For withholdings on payments to these pass-through entities, the withheld amounts would need to be allocated out to shareholders for the S corporation or to the partners, in the case of a partnership. This will increase the complexity of return preparation beyond the contracting entities, extending the allocation issues to the individual returns of the S corporation shareholders or the partners.

General business processes will be slowed. We also can predict that the decreased cash flow will lead to postponement of basic business advances such as hiring, business improvement, research and product development. This is clearly not in the best interests of maintaining a healthy business environment for the small business community.

Tax Compliance? Reporting, Not Withholding.

The purported justification for instituting this 3% withholding tax was a conclusion by Treasury that some recipients of government payments were not reporting and paying their proper share of federal income taxes. If, in fact, this is true, we believe the proper – and least harmful course of action is to require government payers to report such payments.

Many payers of non-wage payments are required to file a Form 1099, which allows the

Internal Revenue Service to match payments with amounts reported on a recipient's return. If this requirement were simply extended to governments, tax administrators would be able to match reported payments with amounts included in revenues by the recipient contractors. The Internal Revenue Service would then be able to cross-reference payments made to a government contractor with revenue reported on that contractor's tax return, and this would address any tax compliance concerns.

The goal here should be to promulgate effective tax compliance measures -- not to punish all government contractors for the perceived non-compliance by an unidentified and unquantified segment of the business community.

Support for Repeal.

CompTIA members are fully supportive of efforts to encourage and promote tax compliance. We believe that all individuals and businesses must be responsible for reporting and paying their fair share of taxes. However, we object to unnecessary and harmful tactics, such as this 3% withholding requirement. This 3% withholding requirement is unfair to small businesses -- especially VARs -- and will force more and more small business out of the competition for federal government procurement opportunities. Accordingly, we call for repeal of this provision, and *we support passage of H.R. 674*. This legislation provides a simple and complete repeal of this withholding requirement.

Conclusion.

It is already very complicated for small businesses to conduct business with the government. The addition of this 3% withholding will add further complexity, making it economically impossible for many small businesses to seek government contracts. We realize that one of the primary goals of this Subcommittee is to promote prosperity and growth for the small business community. With this goal in mind, we ask for your support in overcoming this onerous withholding provision -- which will adversely affect the ability of small businesses to survive, compete and continue to supply governments with essential goods and services.



Construction Industry Round Table

STATEMENT
FOR THE RECORD

BEFORE THE SUBCOMMITTEE
ON
CONTRACTING AND WORKFORCE
OF THE
SMALL BUSINESS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES
RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C.

MAY 26, 2011

Defer No More: The Need to Repeal the 3% Withholding Provision

A hearing to examine the effect of Section 511 of the Tax Prevention and Reconciliation Act of 2005, which will require federal, state, and local governments as well as private sector federal contractors to withhold 3% from all payments for goods and services purchased.

INTRODUCTION

The Construction Industry Round Table (CIRT) is composed of approximately 100 CEOs from the leading architectural, engineering, and construction firms in the United States. Together these firms deliver on billions of dollars of public sector infrastructure projects at the federal, state, and local level that enhance the quality of life of all Americans while directly employing half-million Americans.

CIRT and its members are extremely familiar with and have extensive experience with respect to procurement procedures and the risk/return related to contracting with public clients. As such, the organization believes it is qualified to comment upon the effects of Section 511 (TPPA of 2005) and potential consequences it will have on the companies providing services to the public sector.

DISCUSSION

The process of designing and constructing is one of man's most complex and daunting endeavors. Part of the complexity is the number of parties and interested players that may have a hand in or influence over a given project, add to that the number of layered jurisdictions (federal, state, local, etc.); and one begins to understand the why timelines, budgets, and profit margins are extremely tight and fairly modest when compared to risk.

Safeguards already exist for public clients:

- (1) **Retainage:** The federal practice was to *withhold* ten percent of payments to the contractor until the project was fifty percent complete, whereupon the contract officer could then release either part or all of the retainage to the contractor in his discretion. The federal practice now is not to automatically require in all cases the withholding of a retainage for those contractors exhibiting good past performance histories in job completion; although it still may occur – and does. [48 CFR 432.103 – Progress Payments Under Construction Contracts].
- (2) **Progress Payments:** Construction contracts generally exhibit a unique and complicated system of payment for work completed, consisting of progress payments coupled with retainage. Typically, the general contractor receives periodic payments (usually monthly) based upon the percentage of work actually completed on the project. Progress payments are sometimes tied to completion of specific phases of work. As such, this system allows the owner to hold the contractor continuously accountable for the work schedule, permits the contractor to pay for materials and labor as they are consumed, and allocates the risk of breach between the parties. [48 CFR 52.232.16 – Progress Payments; see, article by Charles Davidson, www.thefreelibrary.com for details].
- (3) **Prompt Pay Requirements:** Implementation of Section 511 will create a conflict of law for general contractors with respect to subcontractor prompt pay requirements. An undue burden and hardship is visited upon each layer of the construction contracting project by the requirement to withhold 3% while at the same time requiring prompt pay under 48 CFR 52.23227 – Prompt Payment for Construction Contracts, which reads in part as follows:

"(ii)(c) Subcontract clause requirements. The Contractor shall include in each subcontract for property or services . . . the following: (1) Prompt payment for subcontractors. A payment clause that obligates the Contractor to pay the subcontractor for satisfactory performance under its subcontract not later than 7 days from receipt of payment out of such amounts as are paid to the Contractor under this contract.

(2) Interest for subcontractors. An interest penalty clause that obligates the Contractor to pay to the subcontractor an interest penalty for each payment not made in accordance with the payment clause . . . ; and (ii) Computed at the rate of interest established by the Secretary of the Treasury, and published in the Federal Register, . . . in effect at the time the Contractor accrues the obligation to pay an interest penalty.

(3) Subcontractor clause flowdown. A clause requiring each subcontractor to (i) Include a payment clause and an interest penalty clause conforming to the standards set forth in paragraphs (c)(1) and (c)(2) of this clause in each of its subcontracts; and (ii) Require each of its subcontractors to include such clauses in their subcontracts with each lower-tier subcontractor or supplier."

(4) Law Enforcement of Tax Payer Compliance: Individual tax payers (including companies) must follow the law with respect to paying taxes on a timely basis – the IRS and Justice Departments are tasked with the responsibility and authority to enforce such laws. It is completely unnecessary and arbitrary to simply withhold 3% from every federal contractor (whether private or public sector) as a means to supposedly ensure compliance.

Practical Shortcomings of Section 511:

In addition to all of the safeguards, regulatory requirements, and legal enforcement activities that already exist that make Section 511 unnecessary, the practical aspects of the section are also called into question.

Federal agencies have indicated (e.g. the Department of Defense) that costs to implement the requirements of Section 511 will far outweigh the illusory benefits or returns reasonably expected from the provision (this especially true when taking into consideration the fact after the first year the collection will be off-set by prior year payouts).

Moreover, from the private sector firms perspective (nearly all of which pay taxes on a timely basis and should not be penalized by the 3% withholding) the delay envisioned by the Section 511 is a burden to cash flow, which in turn will affect timely payments, wage changes, hiring, and even debt and interest payments. Any or all of which are hardships completely unnecessary and unwarranted, especially in an industry segment that is already suffering from a severe 30% downturn (2006 vs. 2011 market activity) and a 17.8% unemployment level – which is nearly twice the 9.0% national average for April 2011.

The federal government does not want to become a client of “last resort” for contractors by making itself less desirable with the withholding of 3 percent of a firm’s cash flow. The *negative* effects on full competition and selection may potentially compromise quality and even the value provided – which can have a financial impact many times the minor amount expected to be collected under the 3 percent provision.

CONCLUSION

Given the practical and legal shortcomings Section 511 exhibits, the Construction Industry Round Table urges Congress to **repeal** the provision, and not just simply defer its implementation.

To that end, **CIRT strongly supports passage of H.R. 674.**



Construction Industry Round Table

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Newburgh, IN 47630

Tel 812.471.5000
Fax 812.475.2544

May 26, 2011

The Honorable Mick Mulvaney; Chairman
The Honorable Judy Chu; Ranking Member
Subcommittee on Contracting and Workforce
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

RE: Submission for the Record – Defer No More: The Need to Repeal the 3% Withholding Provision

Dear Chairman Mulvaney and Ranking Member Chu—

On behalf of Energy Systems Group, I thank you for the opportunity you have provided to allow me to express my views on Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005. I am pleased this important Committee is shining a harsh light on this ill-conceived withholding requirement that will impact negatively many in private industry who do business with government entities.

Energy Systems Group (ESG) is a leading energy services company specializing in sustainable energy solutions that allow federal, local and state government institutions to maximize their energy efficiency and operational performance, while reducing their carbon footprint. Over the last 16 years, ESG has established a strong track record of modernizing government facilities by designing and constructing improvements that pay for themselves through energy savings, an approach called “performance contracting.” ESG has developed more than \$1 billion in facility improvements and energy efficiency projects for customers in various industries, including local, state and federal governments.

The implications of requiring a withholding of three percent of government contracts would be manifold and particularly harmful to smaller firms, such as ESG, and the government as a customer. The withholding of a flat percentage of revenues from government payments bears no relationship to a company’s taxable income. Therefore, businesses with tight profit margins, such as ESG and our competitors in the energy services and performance contracting industries, will be left without vital access to capital that is used to cover day-to-day operating expenses – which would necessarily result in higher costs to the customer (in this case cash-strapped government entities).

The unfunded mandate the withholding represents will impose heavy burdens on governments throughout the country. Administering the program will add increased costs needed to alter the accounting systems, as the mandate is exceedingly complicated to implement. It also will increase the costs of doing business with contractors – an unnecessary burden many local governments cannot reasonably face in these times of severe budget shortfalls and tight resources.

Building Performance With Energy
Evansville, IN; Johnson City, TN; Clearwater, FL;
Indianapolis; Chicago; Atlanta; Raleigh; Richmond; St. Louis and Baltimore

I applaud the many Members of Congress – and the House Small Business Committee – for making the repeal of the three percent withholding requirement a priority. I also applaud the Obama Administration for their recent decision to postpone the implementation of the requirement for another year. However, until this ill-conceived mandate is fully repealed, I, and many businesses like Energy Systems Group, will be forced to make business decisions anticipating its implementation. It is my hope that Congress will work toward making full repeal a reality – and do so in a timely fashion.

Again, thank you for the opportunity to share my views on this important topic in this vital forum.

Sincerely,

A handwritten signature in black ink, appearing to read "Greg Collins", written over a horizontal line.

Greg Collins
President, Energy Systems Group

**OFFICERS****PRESIDENT**

Rob Layne
O.C. Jones & Sons, Inc.

May 18, 2011

SECRETARY/TREASURER

Mike McElroy
FMG, Inc.

House Committee on Small Business
Subcommittee on Contracting and Workforce
2361 Rayburn House Office Building
Washington, DC 20515

BOARD OF DIRECTORS

Nikki Affinito
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RE: H.R. 674 (SUPPORT)

Kevin Albanese
Joseph J. Albanese, Inc.

Jami Brady
BakerCorp

The Engineering and Utility Contractors Association strongly **support H.R. 674**, authored by Representative Herger, which would repeal the three withholding requirement on payments due to vendors providing services to federal, state, and local governmental entities.

Don Cabianca
Cal State Constructors, Inc.

Jerry Condon
Condon-Johnson & Associates, Inc.

The Engineering & Utility Contractors Association is made up of over 450 union-affiliated contractor and associate firms throughout California employing over 25,000 workers. EUCA is the leading contractors' association serving unionized contractors in the Western United States. **The three percent withholding requirement place a massive burden on our members.**

Bruce Diskling
McGuire and Hester

Michael Chiloti
Ghiotti Bros., Inc.

Greg Gruendl
Ray 5 Electric

Steve Lydon
TerraCon Pipelines Inc.

Robert Purdy
RGW Construction, Inc.

Danny Wood, Jr.
D.A. Wood Construction, Inc.

Christian Young
D.W. Young Construction Co., Inc.

The three percent withholding law, which was enacted in Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) as Section 3402(t) of the Internal Revenue Code, mandates that federal agencies, states, and certain local governments withhold three percent of nearly all of their contract payments, Medicare payments, farm payments, and certain grants. Compliance with this law will impose significant, unnecessary financial burdens on both the public and private sectors.

IMMEDIATE PAST PRESIDENTS

Christian Young
D.W. Young Construction Co., Inc.

Andrew Vasconi
A.J. Vasconi General Engineering

Rusty Hoseley
R & L Brosamer, Inc.

Ricky Serrano
R.E. Serrano, Inc.

Fred Ehler
H.F. Ehler Co., Inc.

George Furnanz
Stacy and Witbeck, Inc.

Michael Bauman
Bauman Landscape and Construction, Inc.

Steve Ganey
North Bay Construction, Inc.

Mark Serrano
Magnum Pacific, Inc.

Robert Doud
McGuire and Hester

Jeff Jones
Jones Bros. Enterprises, Inc.

Dave Bianchini
D.E. Bianchini, Inc.

Kenneth Detrick
Detrick Corporation

The withholding is a flat percentage of revenues from government payments, bears no relationship to companies' taxable incomes, and will restrict cash flow needed for day-to-day operations and investments. In addition, the administrative and capital investment costs that compliance with three percent withholding will impose on businesses and governments will be substantial, and the mandate will be exceedingly complicated to implement. Three percent withholding will be especially burdensome for small firms.

For these reasons, we respectfully request that you **SUPPORT H.R. 674 and the repeal of the three percent withholding requirement.**

Sincerely,

Emily Cohen
Director of Government Relations

CHIEF EXECUTIVE OFFICER

Mark Breslin



250 John Knox Road, Suite 2 Tallahassee, FL 32303 Phone: 850-224-2964 Fax: 850-681-6185 www.floridaairports.org

May 19, 2011

The Honorable Sam Graves, Chairman
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Graves:

I write to you on behalf of the 21 commercial service airports, 73 general aviation airports, and the nearly 200 aviation-related businesses, universities, and affiliate organizations located throughout the state that are critical to Florida's trade, travel, and tourism-based economy, that comprise the Florida Airports Council (FAC).

We urge your Committee to repeal Section 511 of the Tax Increase Prevention Reconciliation Act of 2005, commonly known as the "3 percent rule," based on the far-reaching negative impact this law would have on governmental entities and small businesses alike. After careful evaluation of the information published in the Federal Register 26585, Vol. 76, No. 89, we offer the following comments for your consideration.

The law goes into effect for all contracts and payments occurring after January 31, 2012 and will require governmental entities to withhold 3% of all payments over \$10,000. This means that every payment (not invoice) over \$10,000 will need to be reviewed to determine whether it should have withholding or not. Multi-year contracts will mean that extra work is required for every month until every contract existing prior to the January 31, 2012 date is completed.

The regulations permit government entities to withhold on the full amount of a payment that combines an amount subject to withholding and an amount excepted from withholding, *provided the payee has consented to this additional withholding*. It is going to be very difficult to get organizations to give up 3% of a payment that is exempt from withholding as this will affect their cash flow and revenue stream. If the payee does not agree to the additional withholding, then the net check amount cannot be used to calculate the 3% withholding, meaning the Financial Accounting System will need to allow manual calculation of the taxable amount, rather than a multiplication of 3% of the payment amount. Every payment will have to be manually reviewed to determine whether the 3% applies or not, placing a heavy labor burden on government entities who have been downsizing personnel due to reduced property tax revenue, and, undoubtedly mean delays in payments to vendors. In addition, if the vendor does not pay its taxes properly and the governmental entity is found to have withheld an insufficient amount, the governmental entity can be forced to pay the vendors taxes.

The Honorable Sam Graves
Chairman, House Small Business Committee
May 19, 2011
Page 2

If a governmental entity contracts with a prime contractor, the 3% withholding rule applies; however, it does not apply to the subcontractors. This will impact the cash flow to the prime contractor and cause an increase in bid prices to offset the reduction in payment.

Payments by credit card or Other Payment Card is exempted for 18 months after the law goes into effect; however, if Credit Cards are not repealed, then the stores do not recover the complete cost of their funds. For example, if an entity purchases an item on a Procurement Card that costs \$10,000, then the store must remit \$300 to the IRS; therefore, the store is shortchanged its product value by the tax withholding amount. This will result in inflation as the stores increase their prices to cover their profit margins.

The \$10,000 threshold applies to the aggregate of the invoices being paid at one time versus at the individual invoice level. Most accounting systems allow for a taxation flag at the invoice level and post the entries when the invoice is recorded. However, this will require a major re-write of all accounting systems to elect the 3% withholding at the time of check issuance to the vendor. Additionally, remittance time to the IRS is normally 1 to 3 days from the withholding date, which may not allow sufficient time for reconciliation of these amounts.

And, finally, this law also does not allow for annual cost-of-living adjustments to the \$10,000 threshold, which means over time more and more small companies will be forced to adhere to the requirements. This will hamper new development and expansion at a time when small businesses should be encouraged to expand and employ to help our economy recover.

We believe that the law will be difficult to implement accurately, contains penalties to governmental entities that are arbitrary based on the complexity of interpreting its application, will be labor intensive, and will most certainly slow payments to small businesses across the country.

For all of these reasons, we strongly urge your Committee to vote to repeal this measure.

Sincerely,

FLORIDA AIRPORTS COUNCIL



Theodore D. Soliday
President

cc: Florida Congressional Delegation

Statement for the Record Government Withholding Relief Coalition

ON: **Defer No More: The Need to Repeal the 3% Withholding Provision**

TO: **House Committee on Small Business**
 Subcommittee on Contracting and Workforce

DATE: **May 26, 2011**

The undersigned organizations of the Government Withholding Relief Coalition want to thank Chairman Mick Mulvaney and the members of the House Small Business Committee's Subcommittee on Contracting and Workforce for holding this hearing on the sweeping tax withholding requirement mandated by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222).

The Government Withholding Relief Coalition was formed after the passage of the tax reconciliation bill by organizations concerned about the harmful and disruptive effects this provision will have on our members. The Coalition has since grown to more than 125 members representing businesses of all sizes from a diverse range of industry sectors as well as doctors, farmers and state and local government entities.

Section 511 originally created a far-reaching requirement mandating that federal, state, and local governments withhold three percent from payments for goods and services. This provision will affect government contracts as well as other payments, such as Medicare and farm payments. The effective date to implement this three percent withholding tax was initially set for January 1, 2011. It was delayed one year to January 1, 2012, by the American Recovery and Reinvestment Act that was signed into law on February 17, 2009. On May 9, 2011, the Internal Revenue Service (IRS) issued the final rule on the withholding mandate which included a further one-year delay in implementing the three percent withholding tax, making the new effective date January 1, 2013. While these delays have been welcomed by the Coalition, the fact remains that without repeal they simply postpone the inevitable pain that will result as this mandate will negatively impact millions of honest taxpaying businesses, farmers, doctors and hospitals, as well as state and local governments.

While the final rule has incorporated some worthy exemptions and constructive modifications, the law remains a massive and unnecessary burden for the job creators that will be affected as well as federal agencies and state and local governments that will be tasked with putting it into practice. The following list highlights just a few of the problems with the three percent withholding tax:

- **Significant increases in private-sector administrative costs.** The administrative costs to companies – as well as governments – to comply with this withholding requirement will be substantial. Companies’ internal systems are not set up to track the amounts withheld from invoice payments. This will significantly complicate the estimating of tax liabilities on quarterly tax payments. For companies receiving thousands of government payments per year, this will be administratively time consuming and costly.
- **Adverse effects on cash flows of companies.** Compliance with Section 511 will reduce cash assets that are used to pay company employees and other day-to-day expenses. Start-up firms and many industries will be severely impacted by this reduction in cash receipts. The reality for businesses in a wide range of industries impacted by Section 511 is that their profit margins are often less than three percent, which will create serious cash flow issues for these firms.
- **Unfairly burdens honest taxpayers.** More efforts should be focused on identifying and pursuing actual tax “cheats” rather than adding to the administrative burden placed on honest businesses. This mandate treats tax-compliant businesses the same as those illegally avoiding the payment of their tax obligations.
- **Withholding is not based on a taxpayer’s expected liability.** This is unlike withholding on employees’ earnings, which can be adjusted through the W-4 form to more closely reflect the individual’s tax liability. The withholding required by Section 511 is a flat percentage of revenues from government payments, bearing no relationship to companies’ taxable incomes. Therefore, businesses with tight margins – and flow-through entities which rarely owe tax at the entity level – will have their cash flows unnecessarily constrained, which will impinge on cash needed for day-to-day operations.
- **An interest-free loan to the federal government.** The ultimate irony of the three percent withholding tax is that it will cost more to implement than it is estimated to raise in new revenue. A revenue estimate of legislation to repeal the three percent withholding tax vastly overestimates the amount of revenue that would be “lost” without implementation, due to an accounting gimmick. The tax is estimated to “increase” revenue by \$8.2 billion in its first five years but would actually bring in nearly \$6 billion of that amount in the first year solely due to accelerated tax receipts and not to an actual revenue increase from improved tax compliance, effectively providing the federal government with an interest-free loan. Moreover, a private-sector study has estimated that the three percent withholding mandate will cost federal, state and local governments as much as \$75.2 billion in implementation costs during this same time period.

- **Section 511 is causing problems now.** Government contracts frequently cover periods of 5 years or longer in length. This means that businesses entering into these long-term contracts must consider in their pricing the additional administrative and financing costs to implement this requirement. The additional expenses incurred by contractors will increase the costs of goods and services associated with the three percent withholding.

While the members of the Coalition believe that those receiving payments from the government should meet their federal, state and local tax obligations, imposing an onerous 3% withholding tax on transactions between governments and honest taxpaying businesses is not the answer. If Congress fails to act and repeal Section 511, it will have broad and deleterious effects on those in the private sector, particularly small firms, doing business with federal, state, or certain local governments. Ultimately, the increased costs for these services will be passed on to the individual taxpayer with a negligible increase in federal tax revenues. In short, the costs far outweigh the benefits.

The Coalition and the undersigned organizations feel that for these reasons Section 511 should be fully repealed. We strongly urge subcommittee members as well as the remainder of their colleagues in the U.S. House of Representatives to cosponsor H.R. 674, a repeal bill introduced by Representatives Wally Herger (R-CA) and Earl Blumenauer (D-OR).

Sincerely,

Aeronautical Repair Station Association
 Aerospace Industries Association
 Air Conditioning Contractors of America
 Air Transport Association
 Airports Council International-North America
 America's Health Insurance Plans
 American Bankers Association
 American Clinical Laboratory Association
 American Concrete Pressure Pipe Association
 American Congress on Surveying and Mapping
 American Council of Engineering Companies
 American Farm Bureau Federation
 American Gas Association
 American Health Care Association
 American Institute of Architects
 American Institute of Certified Public Accountants
 American Logistics Association
 American Medical Association
 American Moving and Storage Association
 American Nursery and Landscape Association
 American Road & Transportation Builders Association
 American Society of Civil Engineers
 American Subcontractors Association
 American Supply Association

American Traffic Safety Services Association
American Trucking Associations
Armed Forces Marketing Council
Associated Builders and Contractors
Associated Equipment Distributors
Association of Management Consulting Firms
Association of National Account Executives
Association of School Business Officials International
Business and Institutional Furniture Manufacturers Association
CTIA-The Wireless Association
California Association of Public Purchasing Officers
Coalition for Government Procurement
Colorado Motor Carriers Association
Computing Technology Industry Association
Construction Contractors Association
Construction Employers' Association of California
Construction Industry Round Table
Construction Management Association of America
Design Professionals Coalition
Edison Electric Institute
Electronic Security Association
Engineering & Utility Contractors Association
Federation of American Hospitals
Financial Executives International's Committee on Government Business
Financial Executives International's Committee on Taxation
Finishing Contractors Association
Gold Coast Hispanic Chamber of Commerce
Government Finance Officers Association
IPC --- Association Connecting Electronics Industries
Independent Electrical Contractors, Inc
International City/County Management Association
International Council of Employers of Bricklayers and Allied Craftworkers
International Foodservice Distributors Association
International Municipal Lawyers Association
Management Association for Private Photogrammetric Surveyors
Mason Contractors Association of America
Mechanical Contractors Association of America
Medical Group Management Association
Messenger Courier Association of the Americas
Miami Dade County
Modular Building Institute
Munitions Industrial Base Task Force
National Asphalt Pavement Association
National Association for Self-Employed
National Association of Counties
National Association of Credit Management

National Association of Educational Procurement
National Association of Energy Services Companies
National Association of Government Contractors
National Association of Manufacturers
National Association of Minority Contractors
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Chief Information Officers
National Association of State Procurement Officials
National Association of Surety Bond Producers
National Association of Wholesaler-Distributors
National Beer Wholesalers Association
National Corn Growers Association
National Council for Public Procurement and Contracting
National Defense Industrial Association
National Electrical Contractors Association
National Electrical Manufacturers Association
National Emergency Equipment Dealers Association
National Federation of Independent Business
National Institute of Governmental Purchasing
National Italian-American Business Association
National League of Cities
National Mining Association
National Precast Concrete Association
National Office Products Alliance
National Ready Mixed Concrete Association
National Roofing Contractors Association
National Small Business Association
National Society of Professional Engineers
National Society of Professional Surveyors
National Utility Contractors Association
National Wooden Pallet and Container Association
North-American Association of Uniform Manufacturers & Distributors
North Coast Builders Exchange
Office Furniture Dealers Alliance
Oregon Trucking Association
Owner Operator Independent Drivers Association
Plumbing-Heating-Cooling Contractors – National Association
Printing Industries of America
Professional Services Council
Regional Legislative Alliance of Ventura and Santa Barbara Counties
Santa Rosa Chamber of Commerce
Service Disabled Veteran Owned Small Business Council
Sheet Metal and Air Conditioning Contractors National Association, Inc.
Shipbuilders Council of America
Small Business & Entrepreneurship Council
Small Business Legislative Council

TechAmerica
Textile Rental Services Association of America
The Associated General Contractors of America
The Association of Union Constructors
The Distilled Spirits Council of the U.S.
The Financial Services Roundtable
U.S. Chamber of Commerce
United States Telecom Association
Veterans Entrepreneurship Task Force
Water and Wastewater Equipment Manufacturers Association
Women Construction Owners & Executives
Women Impacting Public Policy



SALLY A. HEYMAN
COMMISSIONER

Board of County Commissioners
MIAMI-DADE COUNTY – FLORIDA
STEPHEN P. CLARK CENTER
111 N. W. FIRST STREET, SUITE 220
MIAMI, FLORIDA 33128-1963
(305) 375-5128

The Honorable Mick Mulvaney, Chairman
House Committee on Small Business
Subcommittee on Contracting and Workforce
2361 Rayburn House Office Building
Washington, D.C. 20515

May 18, 2011

Dear Mr. Chairman:

~~I am writing to submit this letter for the record in support of H.R. 674, a repeal of the imposition of 3 percent withholding on payments made to vendors by government entities.~~ This has been a legislative priority I have been working on for several years. Miami-Dade County has a history of quality procurements that result in best value contracts to serve the taxpayer. If section 511 is implemented, it would seriously impact Miami-Dade and Florida's ability to obtain the lowest possible pricing for purchases utilizing public funds and hinder our efforts encouraging economic growth and creation of job.

Miami-Dade County has evaluated the impact of this penalty tax on our entity. Based on 2009-2010 budget figures, the annual value of contracts for goods and services awarded by Miami Dade County was \$2.1 billion, including construction and design. **If this legislation were in place today, the County would likely have to absorb an annual increase in the cost of goods and services in excess of \$63 million annually. This increase in operating costs to the County would certainly result in a significant reduction of support for other important services to our citizens. The projected costs to local Governments in Florida would be in excess of several hundred million.**

Over the past four years, I, along with the county's Department of Procurement Management and our Office of Intergovernmental Affairs have been working closely with the National Association of Counties (NACo), the National League of Cities (NLC), the Government Finance Officers Association (GFOA) and the National Institute of Governmental Purchasing (NIGP) in efforts to repeal the provisions of Section 511. These alliances have led to the formation of the Government Withholding Relief Coalition, led by the U.S. Chamber of Commerce. The Coalition has been instrumental in successfully deferring the implementation of this provision and continues to advocate the repeal of Section 511.

On behalf of Miami-Dade County, we urge committee members to support the repeal of Section 511 as a detrimental tax provision and encourage the passage of H.R. 674 out of the House Committee on Small Business, Subcommittee on Contracting and Workforce. I am enclosing Resolution R-816-10, adopted by the Miami-Dade Board of County Commissioners, which

urges the repeal of Section 511. Additionally, Florida Association of Counties has passed "repeal of Section 511" resolutions for the past three years.

The 3% withholding comes at a time when public budgets are particularly strained, and effective cash management is critical to stimulating our business markets. I thank you for your consideration.

Sincerely,



Sally A. Heyman
Commissioner
District 4

Enclosure

Cc: ~~The Honorable Chair Joe A. Martinez~~
And Members of the Board of County Commissioners
Joe Rasco, Director of Intergovernmental Affairs
Diane Blagman



SALLY A. HEYMAN
COMMISSIONER

Board of County Commissioners
MIAMI-DADE COUNTY – FLORIDA

STEPHEN P. CLARK CENTER
111 N. W. FIRST STREET, SUITE 220
MIAMI, FLORIDA 33128-1963
(305) 375-5128

The Honorable Judy Chu, Ranking Member
House Committee on Small Business
Subcommittee on Contracting and Workforce
B 343-C Rayburn House Office Building
Washington, D.C. 20515

May 18, 2011

Dear Congresswoman Chu:

~~I am writing to submit this letter for the record in support of H.R. 674, a repeat of the imposition of 3 percent withholding on payments made to vendors by government entities.~~ This has been a legislative priority I have been working on for several years. Miami-Dade County has a history of quality procurements that result in best value contracts to serve the taxpayer. If section 511 is implemented, it would seriously impact Miami-Dade and Florida's ability to obtain the lowest possible pricing for purchases utilizing public funds and hinder our efforts encouraging economic growth and creation of job.

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Sally A. Heyman
Commissioner
District 4

Enclosure

Cc: ~~The Honorable Chair Joe A. Martinez~~
And Members of the Board of County Commissioners
Joe Rasco, Director of Intergovernmental Affairs
Diane Blagman



SALLY A. HEYMAN
COMMISSIONER

Board of County Commissioners
MIAMI-DADE COUNTY – FLORIDA
STEPHEN P. CLARK CENTER
111 N. W. FIRST STREET, SUITE 220
MIAMI, FLORIDA 33128-1963
(305) 375-5128

The Honorable Nydia M. Velázquez, Ranking Member
House Committee on Small Business
B 343-C Rayburn House Office Building
Washington, D.C. 20515

May 18, 2011

Dear Congresswoman Velázquez:

I am writing to submit this letter for the record in support of H.R. 674, a repeal of the imposition of 3-percent withholding on payments made to vendors by government entities.

This has been a legislative priority I have been working on for several years. Miami-Dade County has a history of quality procurements that result in best value contracts to serve the taxpayer. If section 511 is implemented, it would seriously impact Miami-Dade and Florida's ability to obtain the lowest possible pricing for purchases utilizing public funds and hinder our efforts encouraging economic growth and creation of job.

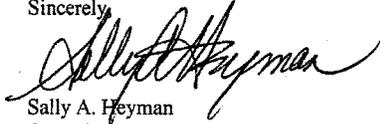
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Sally A. Heyman
Commissioner
District 4

Enclosure

Cc: The Honorable Chair Joe A. Martinez
And Members of the Board of County Commissioners
Joe Rasco, Director of Intergovernmental Affairs
Diane Blagman



SALLY A. HEYMAN
COMMISSIONER

Board of County Commissioners
MIAMI-DADE COUNTY – FLORIDA
STEPHEN P. CLARK CENTER
111 N. W. FIRST STREET, SUITE 220
MIAMI, FLORIDA 33128-1963
(305) 375-5128

The Honorable Sam Graves, Chairman
House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

May 18, 2011

Dear Mr. Chairman:

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Sally A. Heyman
Commissioner
District 4

Enclosure

Cc: The Honorable Chair Joe A. Martinez
And Members of the Board of County Commissioners
Joe Rasco, Director of Intergovernmental Affairs
Diane Blagman

MEMORANDUM

Agenda Item No. 11(A)(2)

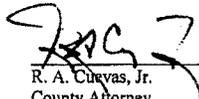
TO: Honorable Chairman Dennis C. Moss
and Members, Board of County Commissioners

DATE: July 20, 2010

FROM: R. A. Cuevas, Jr.
County Attorney

SUBJECT: Resolution urging Congress to
support the repeal of Section 511
of the Tax Increase Prevention &
Reconciliation Act of 2005

The accompanying resolution was prepared and placed on the agenda at the request of Prime Sponsor Commissioner Sally A. Heyman.



R. A. Cuevas, Jr.
County Attorney

RAC/tp

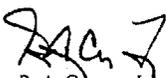


MEMORANDUM

(Revised)

TO: Honorable Chairman Dennis C. Moss
and Members, Board of County Commissioners

DATE: July 20, 2010


FROM: R. A. Cuevas, Jr.
County Attorney

SUBJECT: Agenda Item No. 11(A) (2)

Please note any items checked.

- "3-Day Rule" for committees applicable if raised
- 6 weeks required between first reading and public hearing
- 4 weeks notification to municipal officials required prior to public hearing
- Decreases revenues or increases expenditures without balancing budget
- Budget required
- Statement of fiscal impact required
- Ordinance creating a new board requires detailed County Manager's report for public hearing
- No committee review
- Applicable legislation requires more than a majority vote (i.e., 2/3's ____, 3/5's ____, unanimous ____) to approve
- Current information regarding funding source, index code and available balance, and available capacity (if debt is contemplated) required

Approved _____ Mayor Agenda Item No. 11(A)(2)
Veto _____ 7-20-10
Override _____

RESOLUTION NO. _____

RESOLUTION URGING CONGRESS TO REPEAL SECTION 511 OF THE TAX INCREASE PREVENTION & RECONCILIATION ACT, WHICH REQUIRES CERTAIN GOVERNMENTS TO WITHHOLD THREE PERCENT OF VENDOR PAYMENTS; URGING THE FLORIDA LEGISLATURE TO PASS A MEMORIAL SUPPORTING REPEAL OF SECTION 511

WHEREAS, section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) is set to go into effect on January 1, 2012, and will require states and local governments with annual spending in excess of \$100 million to withhold three percent of payments to contractors or vendors; and

WHEREAS, the three percent withholding is then remitted to the federal government for federal income tax purposes; and

WHEREAS, the goal of section 511 is to reduce underpayment of federal taxes by government vendors not currently subject to withholding, but the provision will have a significant cost impact on state and local governments as well as vendors; and

WHEREAS, Miami-Dade County currently awards approximately \$1.4 billion in goods and services annually; and

WHEREAS, if section 511 were in place today, the annual impact on Miami-Dade County could be in excess of \$42 million; and

WHEREAS, the withholding mandate in section 511 also will create substantial administrative and record-keeping burdens; and

WHEREAS, state and local governments will receive no funding from the federal government in exchange for monitoring and collecting the three percent withholding, and state and local governments likely will incur expense to make programming changes to financial and accounting systems, purchase new software, register vendors, possibly hire additional staff and keep data files and reports,

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF COUNTY COMMISSIONERS OF MIAMI-DADE COUNTY, FLORIDA, that this Board:

Section 1. Urges Congress to repeal Section 511 of the Tax Increase Prevention & Reconciliation Act (TIPRA).

Section 2. Urges the Florida Legislature to pass a memorial supporting the repeal of Section 511.

Section 3. Directs the Clerk of the Board to transmit a certified copy of this resolution to the members of the Florida Congressional Delegation, the Governor of Florida, the Florida Senate President, the Florida House Speaker and the Chair and Members of the Miami-Dade County State Legislative Delegation.

Section 4. Directs the County's federal and state lobbyists to advocate for the passage of the legislation as set forth in Sections 1 and 2 above, and authorizes and directs the Office of Intergovernmental Affairs to include this item in the 2010 and 2011 Federal Legislative Package and the 2011 State Legislative Package.

The Prime Sponsor of the foregoing resolution is Commissioner Sally A. Heyman. It was offered by Commissioner _____, who moved its adoption. The motion was seconded by Commissioner _____ and upon being put to a vote, the vote was as follows:

- | | |
|----------------------|---------------------------------|
| | Dennis C. Moss, Chairman |
| | Jose "Pepe" Diaz, Vice-Chairman |
| Bruno A. Barreiro | Audrey M. Edmonson |
| Carlos A. Gimenez | Sally A. Heyman |
| Barbara J. Jordan | Joe A. Martinez |
| Dorrian D. Rolle | Natacha Seijas |
| Katy Sorenson | Rebeca Sosa |
| Sen. Javier D. Souto | |

The Chairperson thereupon declared the resolution duly passed and adopted this 20th day of July, 2010. This resolution shall become effective ten (10) days after the date of its adoption unless vetoed by the Mayor, and if vetoed, shall become effective only upon an override by this Board.

MIAMI-DADE COUNTY, FLORIDA
BY ITS BOARD OF
COUNTY COMMISSIONERS

HARVEY RUVIN, CLERK

By: _____
Deputy Clerk

Approved by County Attorney as
to form and legal sufficiency.



Jess M. McCarty

**Statement for the Record of the
The House Small Business Subcommittee on Contracting and Workforce Hearing
"Defer No More: The Need to Repeal the Three Percent Withholding Provision"
Thursday, May 26, 2011**

On behalf of the National Association of College and University Business Officers and the higher education associations listed below, we would like to thank Chairman Mulvaney and the Subcommittee on Contracting and Workforce for bringing attention to the serious concerns surrounding the withholding requirement mandated by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222).

We believe compliance with this law will impose significant, unnecessary financial burdens on public institutions of higher education. The requirement will have a disparate impact on state colleges and universities, and some of the larger community colleges, at a time when state support of public colleges and universities continues to deteriorate. While delays in implementation have been welcome, we continue to support full repeal of 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.

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. Section 511 will only serve to exacerbate the financial strains public institutions of higher education are currently experiencing.

Marketplace Impact. The administrative and cost burden of compliance with section 511 will only affect public institutions, and not their private counterparts, creating an uneven playing field in the higher education marketplace. 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.

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.

The undersigned organizations feel that for these reasons Section 511 should be fully repealed.

National Association of College and University Business Officers
American Council on Education
American Association of Community Colleges
American Association of State Colleges and Universities
Association of American Universities
Association of Public and Land Grant Universities



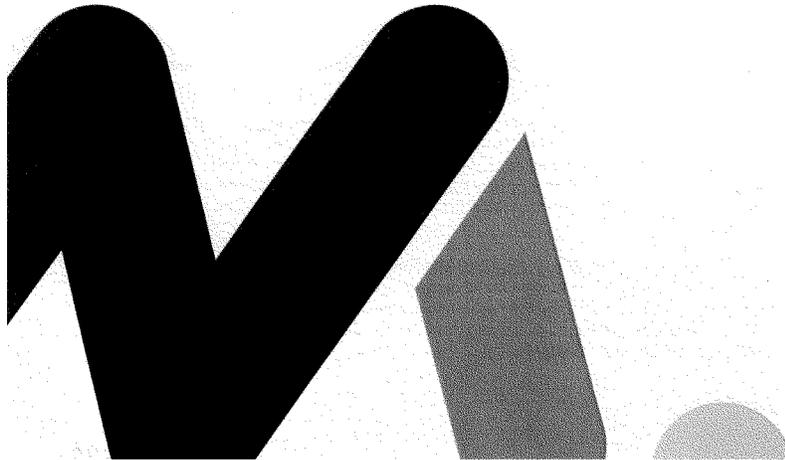
Statement

of the National Association of Manufacturers

***For the record of the Hearing of the House Small Business
Contracting and Workforce Subcommittee***

on The Need to Repeal the 3% Withholding Provision

May 26, 2011



**Statement of
the
National Association of Manufacturers
on
The Need to Repeal the 3% Withholding Provision**

**For the record of the Hearing of the
House Small Business Contracting and Workforce Subcommittee**

May 26, 2011

Mr. Chairman and Members of the Committee,

The National Association of Manufacturers (NAM) is pleased to have the opportunity to submit this statement for the record of the May 26, 2011, House Small Business Contracting and Workforce Subcommittee hearing on The Need to Repeal the 3% Withholding Provision. The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states.

Overview

The Tax Increase Prevention and Reconciliation Act (TIPRA), enacted in 2006, imposes a new three percent withholding requirement on payments from federal, state and local governments to businesses for goods and services. The provision originally was scheduled to go into effect in 2011. In 2009, Congress delayed the effective date until 2012, and in May 2011, the Internal Revenue Service (IRS) postponed the effective date until January 1, 2013.

The withholding requirement was designed to address a so-called "tax gap" problem among a small number of government contractors. In reality, the three percent withholding applies to virtually all government payments to businesses regardless of whether the payments are made by the federal government under a long-term contract or by a local school district to pay for pencils.

The wide scope of the legislation will impose additional costs and a significant administrative burden on all government contractors, and the NAM has opposed this new withholding requirement since it was first enacted in 2006. While manufacturers support delaying the effective date of the provision, we continue to advocate for total repeal of the withholding requirement, which

increases the cost of doing business for manufacturers of all sizes, drawing resources away from much-needed investment and jobs.

Administrative Cost Outweighs Any Benefits

The new requirement imposes a significant compliance burden on businesses. Companies' internal systems typically are not set up to track withholding like this and changing systems could be costly. Moreover, tracking these payments could be extraordinarily complicated in cases involving complex business ventures with multiple partners or subsidiaries.

Additionally, the governments' costs to administer this program are expected to exceed the revenue collected. The new withholding tax on all government payments is estimated to increase tax payments by \$11 billion through 2019, but the Defense Department has estimated that implementation of the tax would cost this agency alone \$17 billion over just five years because of increased contract costs, technology upgrades and administrative overhead.¹ The new requirement likely will result in other unintended negative consequences, including an increase in bid rates to governments.

Even though the new requirement was enacted under the guise of "tax withholding," this new requirement has nothing to do with a company's taxable income or tax liability. The withholding is based entirely on the amount the government pays the business and, in effect, is an interest-free loan to the government. As described in more detail below, companies operating with high volumes and small profit margins would be particularly hard-hit, resulting in the loss of vital funds needed to operate day-to-day activities.

Burden on Small Business

Many small and medium-size manufacturers that contract with the government— especially companies that use sub-contractors for large projects—operate on tight margins and will have difficulty absorbing the cost of the new withholding requirement, thus threatening jobs and overall business operations.

Here is a simple example:

A manufacturer of American flags successfully bids on a government contract and is awarded a \$100,000 contract to make the flags flown over the U.S. Capitol. In order to submit a competitive bid, the manufacturer maintained a three percent profit margin on the contract (\$3,000). Under the new withholding requirement, the government automatically withholds

¹ Letter and report sent by Deputy Secretary of Defense James Finley to the Chairmen of the Senate and House Armed Services committees, April 14, 2009.

three percent of the \$100,000 contract payment and pays the manufacturer \$97,000. In this case, 100 percent of the manufacturer's expected profit of \$3,000 from this contract is withheld by the government. Depending on the company's tax liability, the manufacturer could receive at least part of the withheld amount in a later tax refund. In the meantime however, \$3,000 of the business' revenue stream is being held by the government, leaving the company with less free cash to make more flags.

Conclusion

Manufacturers welcome current efforts within Congress and the Administration to review existing and proposed rules to impose the least burden on society and to maximize net benefits. NAM members believe that the government withholding rule described above is not consistent with the goal of increasing the competitiveness of manufacturing in the United States and will divert from businesses critical resources that could be better used for investment and jobs. We urge Congress to repeal the three percent withholding requirement before it becomes effective in 2013.

Thank you for considering our comments. We look forward to working with you on this important issue.

Statement by:

National Association of Manufacturers
1331 Pennsylvania Ave., N.W.
Suite 600 North
Washington, D.C. 20004-1790
Phone: (202) 637-3000

NAM contact: Dorothy Coleman, (202) 637-3077, dcoleman@nam.org



National Association of Surety Bond Producers

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Phone: (202)686-3700

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Web Site: <http://www.nasbp.org>

E-mail: info@nasbp.org

May 24, 2011

The Honorable Mick Mulvaney
House Committee on Small Business
Subcommittee on Contracting and Workforce

Re: Statement for the Record: Repeal the 3% Withholding Rule

Dear Committee and Subcommittee Members:

On behalf of the National Association of Surety Bond Producers (NASBP), a national trade organization of professional surety bond producers and brokers, whose membership includes firms employing over 5,000 personnel who specialize in surety bonding, issuing bid, performance, and payment bonds for the Nation's construction projects, I would like to thank Chairman Mick Mulvaney and the members of the House Small Business Committee's Subcommittee on Contracting and Workforce for holding this hearing on the sweeping tax withholding requirement mandated by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222).

NASBP is part of the Government Withholding Relief Coalition (GWRC) that was formed to support efforts to repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222), which mandates that federal, state, and local governments with total annual expenditures of \$100 million or more withhold 3% from all payments for goods and services, including payments made to contractors for public works repair or construction. Many other industries and organizations oppose the 3% withholding, including those representing state and local governments, which believe that the collection of the 3% withholding will place too great a burden on resources.

NASBP is concerned that the tax withholding will disadvantage small construction firms significantly, making public construction less desirable for those firms. The withholding will constitute an additional barrier for small firms seeking any public construction work, not just federal government contracts, and may result in less interest by all construction contractors in pursuing public construction, thereby reducing competition for public projects at all levels. The law would impose new and substantial burdens on S corporations and joint ventures. Many government contracts are performed through joint ventures, which increase the competition for public construction projects; additional burdens placed on these entities may reduce competition for public projects.

The 3% withholding applies to the total contract value, not to the net revenue generated from a project. For construction contractors, the government will withhold funds that are necessary to complete a project, such as funds needed to pay for the work of subcontractors and material suppliers. Three percent is larger than the profit margins realized under many government contracts and will significantly impede cash flow, the financial life-blood of all construction firms, thereby jeopardizing a firm's ability to maintain bonding, compete for business, or even complete projects.

For example, if a contractor obtains a \$5 million public contract, the 3% withholding law would require \$150,000 to be held. Meanwhile, the contractor only expects to net \$125,000 after paying subs, suppliers, etc.; therefore, the maximum tax owed on the \$5 million project is \$43,750. However, due to the 3% rule, the government has withheld over 3 times the necessary amount. Furthermore, a private sector study has estimated that the 3% withholding will cost federal, state, and local governments as much as \$75.2 billion to implement in its first five years.

For the reasons given above, the 3% withholding must be repealed to avoid grave injury to the construction industry and the competitiveness of the public procurement system. NASBP appreciates your interest in this matter. Thank you for your consideration of our concerns.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Larry LeClair". The signature is written in a cursive, flowing style.

Larry LeClair
Director, Government Relations

Statement for the Record
Before the
Subcommittee on Contracting and Workforce
Committee on Small Business
U.S. House of Representatives

May 26, 2011

Defer No More: The Need to Repeal the 3% Withholding Provision

Submitted on Behalf of the

Government Finance Officers Association (GFOA)
International City/County Management Association (ICMA)
International Municipal Lawyers Association (IMLA)
International Public Management Association for Human Resources (IPMA-HR)
National Council on Teacher Retirement (NCTR)
National League of Cities (NLC)
National Association of Counties (NACo)
National Association of State Chief Information Officers (NASCIO)
National Association of State Auditors, Comptrollers and Treasurers (NASACT)
National Association of State Budget Officers (NASBO)
National Association of State Procurement Officials (NASPO)
National Association of State Retirement Administrators (NASRA)
National Conference of State Social Security Administrators (NCSSSA)
United States Conference of Mayors (USCM)

Chairman Mulvaney, Ranking Member Chu and Members of the Sub-Committee:

Thank you for holding this very important hearing to discuss a provision that is of the utmost concern to state and local governments. Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) requires federal, state, and local governments to withhold three percent on payments made for most goods and services. This provision not only places a severe administrative and economic burden on state and local governments, but unfairly punishes tax compliant contractors. H.R. 674 would repeal this troubling provision. We hope that this hearing will alert Congress to the importance of passing H.R. 674 immediately.

The groups offering this statement represent state and local governments nationwide that are very concerned with the impact of the three percent withholding provision, on not only state and local governments, but on the small businesses across the country that assist governments by delivering vital public services. Government contractors not only build roads and schools, but they provide numerous critical services to our most underprivileged and needy citizens. The most powerful engine of opportunity and economic growth in this country is small business. We are glad to see that this subcommittee is exploring the effects of Section 511 on these entities.

As you are aware, Section 511 was added to the Tax Increase Prevention and Reconciliation Act during conference negotiations, without input from the entities responsible for implementing this burdensome requirement. While we agree with the law's underlying goal of ensuring that taxpayers pay all of their applicable taxes, placing the burden of enforcing compliance with federal tax laws on state and local governments is an unfunded mandate. This mandate places undue responsibilities on state and local governments and also punishes contractors that do business with those entities. Small businesses across the country will surely be affected, as they will not be able to compete for government contracts due to the increased costs of doing business with the government. The same holds true for subcontractors, who will likely be hit financially as prime contractors are compelled to pass costs associated with the three percent withholding requirement down to their subcontractors.

We know that you will not be surprised by the statement that state and local governments are facing some of the most trying economic times in history, and although economic indicators tell us that we are starting to emerge from the difficult financial times, focusing scarce resources on implementing such a questionable provision simply does not make sense. Now more than ever resources are desperately needed to carry out critical government programs, and government contractors and their employees are an important component in delivering those services.

We recognize that the important focus of this hearing is on the provision's impact on small business. However, we would like to also call your attention to some of the unique challenges state and local governments will face in implementing Section 511.

As you know, the sophistication of the state and local systems needed to capture and report the data required by Section 511 varies greatly between governments. Most entities that we have polled do not currently have the resources, capacity, or staff to undertake the required withholding and remittance processes. Making modifications or purchasing new systems to accommodate this burdensome requirement does not top of the list of state and local priorities during such difficult economic times. Without significant funding, our ability to comply with the three percent withholding requirement, even with the extended implementation date, is questionable.

We estimate that under the new law, the current levels of reporting we undertake will be increased by two to three-fold. Issues inherent in collecting vendor information, undertaking the matching of taxpayer identification numbers (TINs), and the sheer estimated increase in errors and the subsequent error correction processes are daunting. In addition to the increased administrative costs to state and local governments to handle the increased reporting, governments will also face increased costs for goods and services as vendors will simply pass the three percent along.

We reiterate that that the costs associated with this new law bear no tangible benefit for state and local governments. While we agree with the notion of assuring that taxpayers pay all of their applicable taxes, this unfunded mandate places an undue burden on government entities and is a

powerful disincentive for contractors that compete for government business. Building roads and schools, delivering services, and retaining and hiring employees are far better uses for the resources that will be required should this withholding provision stand.

There appears to be a belief that because state and local governments undertake backup withholding, the new requirement will be easy to accommodate. A poll we have conducted on this exact issue has shown that automated backup withholding processes are not the norm. The notion that governments can simply convert the backup withholding process to Section 3402(t) withholding is a misnomer. In many state and local governments across the country, backup withholding is undertaken manually, as it occurs infrequently.

Furthermore, the precedent of requiring lower levels of government to collect what is essentially a federal tax on contractors is concerning for a number of reasons. The federal government should not conscript state and local governments to act as its agents.

State and local governments are not the only entities that will face implementation issues. Businesses will also face enormous administrative and financial challenges as a result of Section 511 at a time when their resources should be focused on creating jobs and encouraging growth. In many cases, the three percent withheld will exceed a government contractor's profit margin and dramatically affect the contractor's cash flow. This, in turn, will reduce the amount of money available for payroll, new business investment, and everyday expenses.

Enhanced transparency and tax compliance should always be a priority; however, we truly believe that there are numerous other more effective and more efficient ways to tackle the issue of vendor tax compliance. Since the passage of Section 511 in 2006, numerous legislative and regulatory provisions have been put into place to focus on increasing tax compliance. Such provisions include:

- The Federal Awardee Performance and Integrity Information System (FAPIIS): A federal legal compliance database requiring contracting officers and grant officials to check for

prospective contractor legal compliance (tax compliance among the records checked) before the award of a federal prime contract.

- **Tax Compliance Certifications on All Contracts:** A federal acquisition rule that requires tax certification language requiring contractors to certify they are current on their federal taxes.
- **Administration Memo on Tax Compliance:** President Obama released a memo requiring the Internal Revenue Service to review the certifications of non-delinquency in taxes that are required on all federal contracts.
- **USASpending.gov:** A single, searchable website, accessible by the public, which includes information on all federal contract and grant awards. This increases transparency for the public of agency prime contract and subcontract spending subjecting awards to increased disclosures to the public.
- **Central Contractor Registration (CCR) Database:** The CCR system has been rolled out to all federal contracting agencies since 2004, and a debt flag was added in 2009.
- **Expansion of the Treasury Offset Program Expanded:** The Treasury Offset Program has been expanded to include state debts.

More information on these initiatives is available on the Government Withholding Relief Coalition's website at www.WithholdingRelief.com.

We believe that the financial and economic costs of implementing Section 511 far outweigh the estimated revenue that the provision is expected to raise and that addressing vendor tax compliance can be achieved without punishing compliant contractors and small businesses. In the interests of state and local governments and the contractors and small businesses that provide goods and services to citizens across the country, we strongly encourage repeal of the three percent withholding provision.

We thank you for recognizing the problematic nature of Section 511 and for holding this important hearing. We hope that this hearing brings important focus to a provision that needs to be repealed immediately. Our members have already expended scarce resources in planning for the implementation deadline. The main goal of state and local governments is and should be

focusing limited resources on the very important task of delivering vital public services, and we hope that Congress will address repeal as quickly as possible.

Michael Belarmino, NACo, (202) 942-4254

Cornelia Chebinou, NASACT, (202) 624-5451

Tina Ott Chiappetta, IPMA-HR, (703) 549-7100 x 244

Lars Etzkorn, NLC, (202) 626-3173

Susan Gaffney, GFOA, (202) 393-8020

Matt Grayson, NASPO, (859) 514-9195

Larry Jones, USCM, (202) 861-6709

Elizabeth Kellar, ICMA, (202) 962-3611

Maryann Motza, NCSSSA, (303) 318-8061

Jeannine Markoe Raymond, NASRA, (202) 624-1417

Brian Sigritz, NASBO, (202) 624-8439

Leigh Snell, NCTR, (540) 333-1015

Charles W. Thompson, Jr., IMLA, (202) 742-1016

Pam Walker, NASCIO, 202-624-8477

Statement for the Record

Lt. General Lawrence P. Farrell Jr. (USAF Ret)

President and CEO

National Defense Industrial Association

House Committee on Small Business

Subcommittee on Contracting and Workforce

Hearing on: Repeal the 3% Withholding Provision

May 26, 2011

On behalf of the 1,754 corporate members and over 90,000 individual members, the National Defense Industrial Association (NDIA) wished to thank Chairman Mick Mulvaney, Ranking Member Judy Chu and all the members of the Subcommittee on Contracting and Workforce, House Committee on Small Business for holding this hearing on the sweeping tax withholding requirements mandated by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222). Since the enactment of Section 511, NDIA has strongly urged the repeal of this unnecessary and costly legislation which we believe will cause harmful and disruptive effects to the entire defense industrial base, and in particular, to our small businesses.

Section 511 created a far-reaching requirement mandating that federal, state, and local governments withhold three percent from payments for goods and services. This provision will affect government contracts as well as other payments, such as Medicare and farm payments. The effective date to implement this three percent withholding tax was initially set for January 1, 2011. In the House passed version of the American Recovery and Reinvestment Act of 2009, section 511 was repealed. However, in the subsequent Conference Committee agreement, the implementation date was delayed one year to January 1, 2012, and the Act (PL 111-5) was signed into law on February 17, 2009. On May 9, 2011, the Internal Revenue Service (IRS) issued the final rule on the withholding mandate which included a further one-year delay in implementing the three percent withholding tax which makes the new effective date January 1, 2013. Although these temporary delays have been welcome, the fact remains that without repeal they simply postpone the inevitable pain that will result as this mandate will negatively impact millions of honest taxpaying businesses, farmers, doctors and hospitals, as well as state and local governments.

While the IRS final rule has incorporated some worthy exemptions and constructive modifications, the law remains a massive and unnecessary burden for the job creators that will be affected as well as federal agencies and state and local governments (all of which have significant budgetary challenges) that will be tasked with putting it into practice. The following list highlights just a few of the problems with the three percent withholding tax:

- **Significant increases in private-sector administrative costs.** The administrative costs to companies – as well as governments – to comply with this withholding requirement will be substantial. Companies' internal systems are not set up to track the amounts withheld from invoice payments. This will significantly complicate the estimating of tax liabilities on quarterly tax payments. For

companies receiving thousands of government payments per year, this will be administratively time consuming and costly.

- **Adverse effects on cash flows of companies.** Compliance with Section 511 will reduce cash assets that are used to pay company employees and other day-to-day expenses. Start-up firms and some industries will be severely impacted by this reduction in cash receipts. For example, often in the construction industry the profit margin on a project is less than three percent which will create serious cash flow issues for firms.
- **Unfairly burdens honest taxpayers.** More efforts should be focused on identifying and pursuing the actual tax cheats rather than adding to the administrative burden placed on honest businesses. This mandate treats tax-compliant businesses the same as those illegally avoiding the payment of their tax obligations.
- **Withholding is not based on a taxpayer's expected liability.** This is unlike withholding on employees' earnings, which can be adjusted through the W-4 form to more closely reflect the individual's tax liability. The withholding required by Section 511 is a flat percentage of revenues from government payments; bearing no relationship to companies' taxable incomes. Therefore, businesses with tight margins will have their cash flows unnecessarily constrained, which will impinge on cash needed for day-to-day operations.
- **An interest-free loan to the federal government.** The ultimate irony of the three percent withholding tax is that it will cost more to implement than it is estimated to raise in new revenue. A revenue estimate of legislation to repeal the three percent withholding tax vastly overestimates the amount of revenue that would be "lost" without implementation, due to an accounting gimmick. The tax is estimated to "increase" revenue by \$8.2 billion in its first five years but would actually bring in nearly \$6 billion of that amount in the first year solely due to accelerated tax receipts and not to an actual revenue increase from improved tax compliance, effectively providing the federal government with an interest-free loan. Moreover, a private-sector study has estimated that the three percent withholding mandate will cost federal, state and local governments as much as \$75.2 billion in implementation costs during this same time period.
- **Section 511 is causing problems now.** Government contracts frequently cover periods of 5 years or longer in length. This means that businesses entering into these long-term contracts must consider in their pricing the additional administrative and financing costs to implement this requirement. The additional expenses incurred by contractors will increase the costs of goods and services associated with the three percent withholding.

While NDIA is a strong believer that those receiving payments from the government should meet their federal, state and local tax obligations, imposing an onerous 3% withholding tax on transactions between governments and honest taxpaying businesses is not the answer. If Congress fails to act and repeal Section 511, it will have broad and deleterious effects on those in the private sector, particularly small firms, doing business with federal, state, or certain local governments. Ultimately, the increased costs for these services will be passed on to the individual taxpayer with a negligible increase in federal tax revenues. In short, the costs far outweigh the benefits.

For these reasons,, NDIA and its members strongly believe that Section 511 should be fully repealed. Mr. Chairman, NDIA again thanks you for your leadership on this most important issue.



May 26, 2011

The Honorable Sam Graves
 Chairman
 House Small Business Committee
 2361 Rayburn House Office Building
 Washington, DC 20515

Dear Chairman Graves:

The National Electrical Contractors Association (NECA) appreciates the opportunity to submit testimony in response to the Subcommittee on Contracting and Workforce of the House Small Business Committee's hearing entitled "**Defer No More: The Need to Repeal the 3% Withholding Provision.**" NECA commends the Committee for the scheduling of a hearing on this important subject. The hearing today will feature witnesses that include the bill sponsor, administration officials, and the business community. NECA commends the Committee for including witnesses from the construction industry, which is significantly impacted by the withholding provision.

NECA supports legislation that would repeal the 3% withholding tax, a provision that was included in Section 511 of the Tax Reconciliation Act of 2005. We urge Members of the House to co-sponsor H.R. 674 (Herger-Blumenauer) to repeal this overreaching requirement.

NECA recognizes that the Internal Revenue Service (IRS) on May 6 issued guidance providing for an additional one-year extension on the withholding by federal, state, and local government entities on payments to persons providing property or services. The withholding requirement will now apply to payments made after December 31, 2012. Notwithstanding the Administration's positive action, NECA believes that Congress should nevertheless proceed with consideration of H.R. 674 and should act immediately to repeal this 3% provision.

For those members of the Committee new to the issue, the 3% provision requires that federal, state, and local governments withhold 3% of payment due to government service providers. This provision affects all government payments for products and services under government contracts as well as payments to any person for a service or product provided to a government entity.

The provision was put in place to help address the tax gap - the difference between the anticipated revenues due to the Treasury and the revenues that actually come into the Treasury. Sponsors of the withholding provision targeted those contractors who failed to pay taxes who continued to secure government contracts. Unfortunately, those 'bad actors' were lumped in with other contractors who paid taxes yet remain subject to the 3% withholding requirement. Instead of focusing on the "tax cheats" that are primarily responsible for the tax gap, Congress used the sledgehammer approach by penalizing honest companies and individuals.

NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION

3 Bethesda Metro Center * Suite 1100 * Bethesda, MD 20814 * 301 657 3110 * 301 215 4500 FAX

WWW.NECANET.ORG

The Honorable Sam Graves
Page 2
May 26, 2011

In fact, Congress would struggle to find any entity that would support the withholding provision. The business community is opposed; state and local governments are opposed to increased paperwork and new procurement procedures. The costs to implement the law exceed the revenues that would, in theory, come in with the law's implementation; studies from the Department of Defense justify such an assertion. The gains to the government are cosmetic and minimal, and amount to a one-time accounting gimmick that wreaks real damage on contractors and state and local governments.

The 3% subject to government withholding represents the estimated profit or operating cash flow on a construction project. Instead of being able to reinvest in one's company, such contractors will lose vital funds needed to operate day-to-day activities, such as material costs, supplies, and other operating expenses. In essence, construction contractors will be "floating" the government a 3% interest free loan.

Current government vendors may ultimately decide not to participate in government contracts which would narrow the pool of companies who bid on federal, state and local projects, thereby further increasing construction costs. Furthermore, small businesses may be driven out of the public sector market all together. Federal construction projects require construction contractors to carry several types of bonds. Surety companies consider companies cash-flow performance when issuing various bonds. The withholding provision will restrict cash-flow making contractors look less profitable leading to higher costs or the denial of coverage for bonds.

Federal construction projects require construction contractors to carry several types of bonds. Surety companies consider companies cash flow performance when issuing various bonds. The withholding provision will restrict cash flow making contractors look less profitable leading to higher costs or the denial of coverage for bonds.

NECA appreciates the opportunity to submit this testimony in conjunction with today's hearing.

NECA is the nationally recognized voice of the electrical construction industry, comprised of over 80,000 electrical contracting firms, employing over 750,000 electrical workers and producing an annual volume of over \$125 billion in electrical construction. NECA includes 120 U.S. chapters in addition to several affiliated international chapters around the world.

Sincerely,



John M. Grau
Chief Executive Officer



National Roofing Contractors Association
 Washington, D.C. Office
 324 Fourth Street, N.E.
 Washington, D.C. 20002
 202/546-7584
 Fax: 202/546-9289
<http://www.nrca.net>

May 26, 2011

The Honorable Mick Mulvaney
 Chairman
 Subcommittee on Contracting and Workforce
 Committee on Small Business
 2361 Rayburn House Office Building
 Washington, D.C. 20515

The Honorable Judy Chu
 Ranking Member
 Subcommittee on Contracting and Workforce
 Committee on Small Business
 2361 Rayburn House Office Building
 Washington, D.C. 20515

Dear Chairman Mulvaney and Ranking Member Chu:

The National Roofing Contractors Association (NRCA) commends you for holding a hearing of the Small Business Contracting and Workforce Subcommittee to discuss the negative impacts of the three percent withholding tax on government contractors. NRCA strongly supports the immediate repeal of the withholding tax mandated in Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) through prompt passage of the Withholding Tax Relief Act of 2011 (H.R. 674). Repeal of the withholding law, which adds a new layer of complexity to a contractor's tax filing, is vital to job creation and economic growth in the roofing industry.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. NRCA's approximately 4,000 members are located in all 50 states and typically are small, privately held companies, with the average member employing 45 people in peak season and attaining sales of about \$4.5 million per year.

If the withholding law is not repealed, roofing contractors performing government work will face serious repercussions. The mandated three percent of the contract that is withheld is taken off the total value of that contract, not the profit earned on the project. Given that three percent or less of the total contract is the average profit margin in our industry, withholding could eliminate contractors' profits on many projects, thus severely limiting the ability of contractors to grow their business and create jobs.

While the contractor may collect the three percent that is withheld at the end of the year, cash-flow and operating capital disruptions caused by withholding will be a tremendous burden, particularly for small businesses. The bookkeeping systems of many small businesses are not set up to account for such large amounts withheld from invoices. Withholdings will also complicate tax filings and the need to accurately determine tax liability. This new complexity will create added compliance costs on businesses and thus will further impair efforts to create jobs. Many roofing contractors will be forced to stop bidding on government contracts in order to avoid these added complexities. Also, contractors continuing to perform government work may be forced to pass additional costs created by withholding along to the government and taxpayers.

The Government Withholding Relief Coalition, of which NRCA is a member, recently released a cost impact study of the three percent withholding law. The study estimates implementation costs for federal, state, and local governments to be about \$20.2 billion over five years. Given that the Joint Committee on Taxation estimated in 2006 that the withholding tax will raise roughly \$7 billion over 10 years, it does not make good fiscal sense to allow the withholding requirement to take effect, even from the government's point of view.

As you know, the Internal Revenue Service (IRS) recently issued final regulations delaying the implementation of the withholding tax for one year. Despite this delay, NRCA recognizes the fundamentally flawed nature of this policy and urges Congress to act quickly to repeal this requirement, which further complicates the tax filing of government contractors and stifles job creation. Even with the brief delay issued by the IRS, the withholding will begin impacting contractors soon, as businesses must begin tailoring their bookkeeping systems in anticipation of the provision taking effect at the beginning of 2013.

Thank you for your consideration of NRCA's views. Please contact NRCA's Duane Musser or Brandon Audap at (202) 546-7584 if you have questions or need more information about NRCA's position on this important issue.

Sincerely,

A handwritten signature in black ink, appearing to read "T. Allen Lancaster". The signature is fluid and cursive, with a large initial "T" and "A".

T. Allen Lancaster
President, Metalcrafts Inc., Savannah, GA
President, NRCA



BILL CAMPBELL

CHAIRMAN
ORANGE COUNTY BOARD OF SUPERVISORS
SUPERVISOR, THIRD DISTRICT

ORANGE COUNTY HALL OF ADMINISTRATION
333 W. SANTA ANA BLVD.
10 CIVIC CENTER PLAZA, SANTA ANA, CALIFORNIA 92701
PHONE (714) 834-3330 FAX (714) 834-2786
bill.campbell@ocgov.com

May 25, 2011

Hon. Mick Mulvaney, Chairman
Subcommittee on Contracting and Workforce
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

Hon. Judy Chu, Ph.D., Ranking Minority
Member
Subcommittee on Contracting and Workforce
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

RE: Repeal the Imposition of Three Percent Withholding on Certain Payments Made to Vendors by Government Entities – SUPPORT

Honorable Members:

The County of Orange supports the complete repeal requiring governmental entities to withhold three percent of payments due to vendors providing goods and services because implementation will be costly and administratively burdensome for the County and negatively impact businesses.

The withholding process poses a burden upon the County as it would require additional staffing for development and implementation of a collection and remittance process, for coding transactions, and performing reconciliation and reporting functions. Implementation will likely require reprogramming, or costly modifications of financial and accounts payable systems to capture and account for the required withholding. Additionally, there would be a significant workload impact upon departmental Purchasing staff, as the legislation would require renegotiation of current contracts to include the withholding provisions.

If implemented, Section 511 would be detrimental to small businesses that seek to contract with the County, thereby reducing competition for local contracts. The result of reduced competition may result in the County paying higher prices for services, as vendors may simply choose to increase their price offers in order to compensate for the withholding and minimize their loss of revenue. For FY 09-10, the County of Orange generated approximately \$900 million in contracts, which equates to \$27 million in withholding. The County will likely have to absorb this three percent increase, seriously impacting the ability to obtain the lowest possible pricing for purchases utilizing public funds. This increase in operating costs, on top of the current financial crisis, may result in a significant reduction of support for critical services to citizens of Orange County.

Companies with typically tight margins or irregular cash flows would lose vital funds needed for day-to-day operations, and would be at a competitive disadvantage in the procurement process. This gives rise to the concern that implementation of Section 511 will discourage vendors from bidding on government contracts; the resultant reduced competition would also result in increased pricing. This is inconsistent with professional procurement practices that call for full and open competition leading to best value purchases in the public arena.

Honorable Mick Mulvaney
Honorable Judy Chu, Ph.D.
May 25, 2011
Page 2

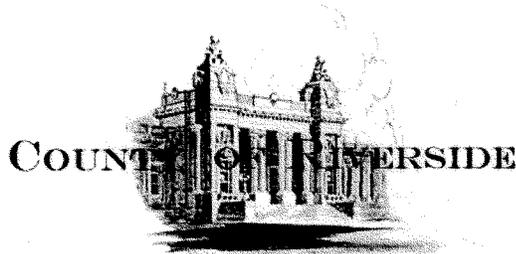
Your consideration of our position is appreciated. If you, or a member of your staff, have questions about this, please contact Donna Grubaugh, Director, CEO/Legislative Affairs at (714) 834-7218.

Sincerely,

A handwritten signature in cursive script that reads "Bill Campbell". The signature is written in black ink and is positioned above the printed name and title.

BILL CAMPBELL
Chairman of the Board
Supervisor, Third District

cc: Members, Board of Supervisors
Thomas G. Mauk, County Executive Officer



Board of Supervisors

District 1	Bob Buster 951-955-1010
District 2	John F. Tavaglione 951-955-1020
District 3	Jeff Stone 951-955-1030
District 4	John Benoit 951-955-1040
District 5	Marion Ashley 951-955-1050

May 25, 2011

The Honorable Judy Chu
 Ranking Member
 Subcommittee on Contracting and Workforce
 Committee on Small Business
 U.S. House of Representatives
 Washington, D.C. 20515

Dear Congresswoman Chu:

I am writing you on behalf of the Riverside County Board of Supervisors to express their support for H.R.674, introduced by Congressman Herger (R-CA), which will repeal the imposition of withholding on certain payments made to vendors by government entities.

H.R. 674 will repeal of Section 511 of the Tax Increase and Reconciliation Act of 2005 (P.L. 109-222) which will require Federal, State, and local government entities to withhold three percent of their payments to most vendors and contractors beginning in 2012. This requirement will involve administrative efforts and costs with no return to the County. As an example of the scope of the administrative burden, during FY 2010, the County issued payments to 4,764 vendors totaling \$481,753,737. To withhold the required three percent on each payment will not only consume County labor and system resources, it could create a negative impact on the County's vendors, increasing costs and cause some of them, especially the smaller, local business to withdraw from doing business with the County. Further impact will be felt on the small to midrange business without large accounting staff who will find this one more piece of cumbersome "red tape" in doing business with government and move their efforts elsewhere. The small businesses are some of the County's best service providers, and provide employment for local residents who in turn spend their money in our County.

Please support H.R. 674 or similar legislation that will repeal this unfunded and burdensome mandate.

Sincerely yours,

Thomas P. Walters
 Washington Representative

TPW:sbm

STATEMENT FOR THE RECORD

United States House of Representatives

**Committee on Small Business
Subcommittee on Contracting and Workforce**

Defer No More: The Need to Repeal the 3% Withholding Provision

**Submitted by
UNIVERSITY OF ILLINOIS**

May 26, 2011

**Judith Flink, Executive Director of University Student Financial Services
University of Illinois, UIC, UIS and UIUC
809 S. Marshfield, Suite 228
Chicago, Illinois 60612
312-996-2515
jflink@uillinois.edu**

Chairman Mulvaney and Ranking Member Chu,

The University of Illinois appreciates the opportunity to provide testimony to the Subcommittee on Contracting and Workforce in support of repeal of the wasteful and burdensome 3 percent federal tax withholding requirement on payments to our vendors. We support legislation in the House, H.R. 674 and similar Senate legislation that would repeal the provision found in Section 511 of the Tax Prevention and Reconciliation Act of 2005 (PL 109-222) which will require federal, state and local governments to withhold 3% from all payments for goods and services purchased from small businesses beginning on January 1, 2013. We urge the adoption of this legislation without delay.

The University of Illinois is a public, State institution with three main campuses in the State of Illinois, Champaign-Urbana, Chicago and Springfield. We enroll more than 76,000 students at our campuses with thousands more who take courses on-line and off campus. We employ approximately 18,000 individuals and serve as an economic engine in our state, creating another 150,000 jobs.

As a State institution, all purchases at the University of Illinois must be made according to the provisions of the Illinois Procurement Code, the Procurement Rules of the Chief Procurement Officer for Public Institutions of Higher Education, and other applicable government regulations. Procurements, and vendors, are scrutinized by the State government and the Legislature.

With 800 buildings and a budget of \$4.76 billion, the University enters into thousands of contracts each year with vendors large, medium and small for a huge range of services. Most procurement contracts are subject to a competitive bidding process in order to ensure that the University obtains services at the lowest possible price from vendors that are honest and reputable, which includes paying their tax obligations.

The requirement that the university begin withholding 3 percent of payments to all vendors on behalf of the federal government will result in dramatically increased administrative burden for our campus. This will add expenses at a time when our university, like many others around the country, is facing reduced State support. We would have no choice but to pass these expenses on to our students, many of whom are also struggling to make ends meet. This comes at a time when we are working extremely hard to reduce administrative and other costs in order to avoid tuition increases while maintaining the world class academic and research capacity of the university that helps drive economic growth in our State and nation.

It is our understanding that the requirement to withhold 3 percent of payments to vendors will have a marginal or possibly even a negative effect on the federal budget in the long term. It is clear that this requirement will have a negative effect in both the short and long term on the State of Illinois and on the University of Illinois, its students and other universities nationwide.

We urge you to repeal Section 511 and to do so quickly. In order to prepare to meet the January 1, 2013 effective date for the withholding requirement, the university will need to begin modifying our payment systems while at the same time modifying our contracts with vendors. This may require a massive renegotiation of those contracts to provide for the 3 percent withholding requirement as well as changes to future requests for proposals. This will be another major, unnecessary administrative cost that will fall not only on the University but also on the vendors themselves, who in turn will be forced to

increase their prices. Thus, the University will ultimately be faced not only with its own increased administrative costs, but also some, if not all, of the passed-on costs of the vendors.

As a government institution, the University of Illinois recognizes that taxes are necessary to pay for public services and that our vendors should pay their fair share. However, the 3 percent withholding requirement represents an inefficient method of tax collection that will impose a costly burden on the States and public universities at time when we can least afford it.

For all these reasons, the University of Illinois urges its repeal. We appreciate the opportunity to submit this testimony for the record.



Statement for the Record

U.S. Chamber of Commerce

ON: Defer No More: The Need to Repeal the 3% Withholding Provision

**TO: THE HOUSE COMMITTEE ON SMALL BUSINESS
 SUBCOMMITTEE ON CONTRACTING AND WORKFORCE**

DATE: May 26, 2011

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Statement for the Record
“Defer No More: The Need to Repeal the 3% Withholding Provision”
Submitted to
THE HOUSE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
on behalf of the
U.S. CHAMBER OF COMMERCE
May 26, 2011

The U.S. Chamber of Commerce thanks Chairman Mick Mulvaney and the members of the House Small Business Committee’s Subcommittee on Contracting and Workforce for holding this hearing on the sweeping tax withholding requirement, commonly known as the 3% withholding tax, mandated by Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (PL 109-222).

Unless it is repealed, the 3% withholding tax will have a negative impact on millions of honest taxpaying businesses, farmers, doctors and hospitals, as well as state and local governments. Under this provision, the Internal Revenue Service (IRS) was given new broad sweeping authority to hold hostage 3% of nearly every transaction between the public and private sector—giving the federal government an interest free loan on the backs of many honest taxpayers.

In order to comply with the mandate, companies of all sizes that do business with the government will need to develop new internal accounting systems to track, handle and reconcile these payments. The cost to develop these systems will be passed on to the government, with the ultimate cost being borne by individual tax payers. The 3% withholding tax is particularly problematic because it reduces capital needed for day-to-day operations. While some firms may need to take on higher levels of debt to ensure regular cash flows, all companies will see working capital shifted from productive investments to non-productive use. To cover their costs, businesses will need to increase their bid rates for projects in order to maintain the same profit margins, thus raising the cost to taxpayers and squeezing already cash-strapped state and local governments.

Another serious concern is that the withholding requirement is based on a company’s revenue stream, which bears no relationship to its tax liability. This is unlike withholding on employees’ earnings, which can be adjusted through the W-4 form to more closely reflect the individual’s tax liability. Because of this inflexibility, companies with tight margins will have their cash flows unnecessarily constrained, which will impinge on cash needed for day-to-day operations. In addition to the costs to the business sector, the 3% withholding tax comes with significant costs to all levels of government which must develop new accounting systems to track and match the multitudes of withheld payments and generate the proper forms for the Internal Revenue Service. It should be noted that the Congressional Budget office indicated that the provision was an unfunded mandate¹.

¹ CBO letter dated May 9, 2006, <http://www.cbo.gov/ftpdocs/71xx/doc7198/hr4297conf.pdf>

Section 511 will have broad and deleterious effects on firms doing business with federal, state, or local governments. Ultimately, the increased costs for these services will be passed on to the individual taxpayer with a negligible increase in federal tax revenues.

Testimonials from a couple of the Chamber's small business members particularly illustrate the problems with this mandate:

"The 3% withholding will have a severe negative impact on Buffalo Supply. As a small business distributor of medical equipment we operate on very slim margins. The amount of the withholding would be several times our tax liability. This withholding would cause our company to go out and attempt to borrow money so we can loan it to the IRS for free. As you may know, it is not easy for small businesses to get credit in this economic environment. The net result will be a negative impact on our ability to hire additional employees.

The cost to change our accounting software will be substantial. While I am grateful that the withholding has been delayed, small businesses need a final resolution. We cannot wait until the last minute to prepare for this withholding. I have little to no confidence that the money withheld would actually get to the proper accounts. Resolving the differences would create unneeded and costly conflicts between our small business and the IRS.

This withholding will cause a lot of problems for small businesses and helps no one, including the IRS. We lease equipment to hospitals. We then sell the lease to a bank. Who gets the 3% withholding, Buffalo Supply or the Bank? The federal government often makes the payments to the wrong party. Currently when Buffalo Supply receives a payment that should have gone to the bank, we just endorse the check over to the bank. If there is a withholding involved we cannot do that. The resulting payment delays will negatively affect cash flow, and increase the cost of leases to the taxpayers."

Harold Jackson
Chief Executive Officer
Buffalo Supply, Inc.
Lafayette, CO

"The intent of the legislation is to insure that contractors properly pay taxes. As an S-Corp our tax liability flows down to the individual owners of the company and thus no corporate taxes are due. Withholding payment for services or products provided to the government to insure proper payment of taxes which are never due makes no sense and accomplishes nothing.

As a small company with less than 500 employees we will need to hire at least one additional administrative person to track this 3% withholding. Under cost reimbursable contracts, this additional cost will be directly passed along to the

government. This is counterproductive at a time when the federal government is trying to reduce costs and improve efficiencies.

This is a huge administrative burden especially considering that as an S-Corporation we owe no corporate taxes. Under our cost reimbursable contracts this additional no-value added cost will be passed along to the government at a time when our customers are looking for ways to reduce costs.”

Philip L. Soucy
Co-President & CEO
Modern Technology Solutions, Inc.
Alexandria, VA

While we firmly believe every business should pay its full tax obligations, Section 511 attempts to close the tax gap in a particularly onerous way – by dramatically increasing the burden on the already compliant taxpayers and passing a huge portion of the cost for collecting and tracking payments onto state and local governments.

In short, the costs far outweigh the benefits. Section 511 should be fully repealed.



Women Construction Owners & Executives, USA

1004 Duke Street, Alexandria, VA 22314 ♦ p (800) 788-3548 ♦ f (202) 330-5151 ♦ www.wcoeusa.org

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Kansas City, MO

May 27, 2011

The Honorable Sam Graves
Chairman, Small Business Committee
United States House of Representatives
Washington, DC 20515

Dear Chairman Graves:

We are writing to thank you for cosponsoring H.R. 674 to repeal the three percent withholding requirement on payments due to vendors providing services to federal, state, and local government entities. Women Construction Owners & Executive, USA (WCOE) is a national association representing women owners and executives in the construction industry. Members of WCOE include general contractors, architects, engineers, manufacturers, construction project managers, and subcontractors.

As you know, federal, state, and local governments will be required to withhold three percent of their payment for goods and services starting in 2013. This affects all government contracts as well as any payments to individuals for a service or product provided by a government entity. Implementing this law would be costly for businesses, including our members, and the government.

This is particularly burdensome to small businesses whose profit margins could become non-existent because of this withholding. The mandated withholding becomes yet another regulatory measure for small businesses to comply with.

Failure to repeal this mandate will have far reaching effects on the small business community as well as the economy which depends on small business growth for job creation. We thank you for cosponsoring this important legislation.

Sincerely,

Penny Pompei

National Executive Director
penny@wcoeusa.org



May 27, 2011

The Honorable Sam Graves
Chairman, Small Business Committee
United States House of Representatives
Washington, DC 20515

Dear Chairman Graves:

We are writing to thank you for supporting the repeal of 3% tax withholding, which will require federal, state and local governments to withhold 3% of contract payments for goods and services. Women Impacting Public Policy (WIPP) is a national, nonpartisan organization representing 54 organizations and over half-a-million women business owners nationwide.

As you know, businesses contracting with federal, state or local governments will have 3% of the total government contract payment withheld for tax purposes starting in January 2013. This new requirement poses a number of problems for small businesses, including many WIPP members, who are government contractors. It will deny small businesses the funds necessary to complete jobs, restrict small business cash flow, and impair the ability of small businesses to compete for government contracts. In addition, complying with the law's requirements will cost small businesses time and money, further preventing economic growth.

We thank you for cosponsoring legislation to support the repeal of the 3% withholding requirement.

Sincerely,

Barbara Kasoff, President and CEO
Women Impacting Public Policy

county of ventura

COUNTY EXECUTIVE OFFICE
Thomas P. Walters
Washington Representative

May 25, 2011

The Honorable Mike Mulvaney, Chairman
Subcommittee on Contracting and Workforce
Committee on Small Business
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing you on behalf of the Ventura County Board of Supervisors to express their support for H.R.674, introduced by Congressman Herger (R-CA), which will repeal the imposition of withholding on certain payments made to vendors by government entities.

H.R. 674 will repeal of Section 511 of the Tax Increase and Reconciliation Act of 2005 (P.L. 109-222) which will require Federal State, and local government entities to withhold three percent of their payments to most vendors and contractors beginning in 2012. This requirement will involve administrative efforts and costs with no return to the County. As an example of the scope of the administrative burden, during FY 2009-10, the County issued 51,102 payments to 14,045 vendors totaling \$407,962,196. To withhold the required three percent on each payment will not only consume County labor and system resources, it could create a negative impact on the County's vendors, increasing costs and cause some of them, especially the smaller, local business to withdraw from doing business with the County. Further impact will be felt on the small to midrange business without large accounting staff who will find this one more piece of cumbersome "red tape" in doing business with government and move their efforts elsewhere. The small businesses are some of the County's best service providers, and provide employment for local residents who in turn spend their money in our County.

Please support H.R. 674 or similar legislation that will repeal this unfunded and burdensome mandate.

Sincerely yours,



Thomas P. Walters
Washington Representative

TPW:sbm

county of ventura

COUNTY EXECUTIVE OFFICE
Thomas P. Walters
Washington Representative

May 25, 2011

The Honorable Elton Gallegly
U.S. House of Representatives
2309 Rayburn House Office Building
Washington, D.C. 20515

Dear Elton:

I have sent the attached letters to Chairman Mulvaney and Ranking Member Chu of the House Small Business Subcommittee on Contracting and Workforce on behalf of the Ventura County Board of Supervisors to express their support for Congressman Herger's H.R. 674 that will require Federal, State, and local government entities to withhold three percent of their payments to most vendors and contractors beginning in 2012. The Board respectfully request that you co-sponsor H.R. 674.

Please support H.R. 674 or similar legislation that will repeal the three percent withholding requirement.

Sincerely yours,



Thomas P. Walters
Washington Representative

TPW:sbm

Enclosures