



AMERICAN COUNCIL OF ENGINEERING COMPANIES

Overturn the 3% Withholding Mandate

ISSUE

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) is a sweeping new requirement mandating that federal, state, and local governments withhold three percent from payments for goods and services. The law, which takes effect in 2011, will cover all such payments made by the federal government and state governments, as well as local governments that have annual expenditures that exceed \$100 million.

ACEC is deeply concerned about the impact and unintended consequences of this new requirement on all companies that receive contracts or other forms of government payments. The withholding mandate will apply to the total cost of the contract, not to the net revenue generated or the size of the company. As a consequence, government agencies may see the cost for goods and services increase as firms seek to offset the impact of the three percent tax withholding mandate.

In addition, because the profit margin for engineering and construction services on public projects is often less than three percent, the new mandate creates very serious cash flow problems for companies providing vital services to government agencies and the public. The law will also impose significant administrative costs and information reporting requirements on governments and businesses. This will be a serious concern for subchapter S corporations and other pass-through entities because these withholdings will have to be reported to each partner in the partnership and will affect their tax liability. For state and local governments, the withholding requirement represents an unfunded mandate at a time when budgets are stretched to the limit.

KEY POINTS

- *The provision was designed to deter tax evasion, but it will primarily penalize honest taxpayers.*
- *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.*
- *The new mandate will have an adverse effect on smaller firms, as prime contractors may be compelled to pass the costs associated with the three percent withholding requirement to their subcontractors, or possibly shift from subcontracting work out to performing it internally.*

ACTION REQUESTED

- **Cosponsor legislation introduced in the House by Representatives Kendrick Meek (D-FL) and Wally Herger (R-CA) and its Senate counterpart – H.R. 1023 and S. 777 – to repeal Section 511.**
- **Oppose efforts to broaden the withholding requirement or speed up its implementation.**