

REPEAL THE 3% GOVERNMENT WITHHOLDING TAX

Position:

The National Electrical Contractors Association (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 Congress to co-sponsor H.R. 275 (Meek-Herger) and the companion legislation S. 292 (Specter) to repeal this overreaching requirement.

Issue:

A new tax law contains requirements that federal-state-local governments withhold 3% of payment due to government service providers. Effective in 2012, 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.

A study conducted by the Department of Defense estimated that the costs to implement the 3% withholding requirement will be over \$17 billion over the first five years. Estimated increases in revenue were identified as \$7 billion over the same time period.

This presents a particular problem for small businesses in a competitive industry such as construction. The 3% subject to government withholding represents the estimated profit or operating cash flow on a construction project. Contractors will lose vital funds needed to operate day-to-day activities, such as material costs, supplies, and other operating expenses. Instead, construction contractors will be “floating” the government a 3% interest free loan. This is especially damaging in construction since contractors already face a withheld percentage of up to an additional 10% of progress payment on government projects, commonly referred to as retainage.

Status:

The 2009 Economic Stimulus legislation (American Recovery and Reinvestment Act) delayed implementation of the 3% withholding tax until January 1, 2012.

Key Points:

- Supporters of the 3% provision believe the advance tax payments will help promote fairness in the tax system and close the government’s “tax gap” – the difference between the amount due to the Treasury in the form of tax payments.
- NECA is concerned that Congress could potentially make matters worse by either increasing the withholding percentage or accelerating the effective date in order to “pay for” other programs in need of funding.
- 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 provision is estimated to provide a one-time federal revenue windfall of \$6 billion in 2001 solely due to accelerated tax receipts.
- Instead of focusing on the “tax cheats” that are primarily responsible for the tax gap, Congress is using the sledgehammer approach by penalizing honest companies and individuals.
- 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 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.



National Electrical Contractors Association

NECA is the voice of the \$120 billion industry responsible for bringing lighting, power, and communications to buildings and communities across the United States. NECA’s national office and 119 local chapters advance the electrical contracting industry through advocacy, education, research, and standards development.

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For additional information: 301-215-4522 phone, 301-215-4500 fax, www.necanet.org