

Withholding

Speakers at IRS Hearing to Raise Underlying Problems With Public Contractor Withholding

Speakers at a Sept. 12 Internal Revenue Service hearing on contractor withholding regulations plan to broach a variety of issues surrounding the fundamental policy that the service has not addressed in guidance.

The hearing will center around proposed regulations (REG-151687-10) on a 3 percent withholding requirement on government payments to contractors that were released in May (89 DTR G-6, 5/9/11).

The proposed regulations delay the effective date to Jan. 1, 2013, of provisions of final rules (T.D. 9524) that were released at the same time. The withholding requirement created by the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222) was originally set to be implemented in 2012.

Although the proposed regulations do not delve into the issue of withholding, several of those who have asked to speak at the hearing told BNA Sept. 8 they plan to discuss underlying problems with the policy.

"However, we hope to take the opportunity to again emphasize that there's other issues that have not been covered by the proposed regs and, of course, there are things within the proposed regs that many people would like to see changed to a degree," Rich Shavell, with the Associated Builders and Contractors Inc., told BNA.

S Corporations Raise Special Concern Shavell's comments will mostly follow previous comments submitted by ABC Inc., but he also plans to discuss other issues that have not been addressed, he said.

For example, he will talk about problems facing S corporation shareholders who will have to pay taxes on the withholding amount because the credit for the withholding amount could be treated like excess dividend distributions subject to taxation as a capital gain.

IRS is aware of the issue, but Shavell said he did not think the service had a solution or intended to address the problem.

Some Industries Face Profit Problems. For firms in the architecture, engineering, surveying, and mapping industries another regulatory withholding policy was causing problems, John Palatiello, executive director of

Management Association for Private Photogrammetric Surveyors (MAPPS), told BNA. The withholding could be as high as 10 percent, which meant these business could face a 13 percent withholding on contracts.

The federal procurement regulations have since been revised so that the 10 percent withholding can be negotiated to a lower rate, he said. Some firms, however, can still face a higher federal withholding on their fees. The high withholding rates are an "extraordinary burden on small business" and can be higher than the profit margin on the contract, he said.

"So you basically have a small business playing banker to the government, loaning money at no interest to government, which is a really impossible situation for a business to be in and to operate profitably," Palatiello said.

Profit margins are also a problem for the construction industry, spokesman for the Associated General Contractors of America Brian Turmail told BNA. The average profit for construction companies is around 3 percent, which will mean contractors would be doing the work for no profit until the firms get their tax returns, he said.

This can be especially important in the current economic climate where most of the construction work is coming from government contracts because private sector construction has slowed, Turmail said. Stephen Sandherr, the chief executive office for the AGC, will be delivering the group's remarks at the Sept. 12 hearing.

Tom Wilder with America's Health Insurance Plans and Roger Jordan with the Council of Defense and Space Industry Associations will also speak at the hearing, according to IRS.

Speakers Pushing for Repeal. The speakers agreed that the law needs to be repealed.

Payors and payees do not like this law, Shavell said. Governmental bodies on all levels will be faced with increased administrative burdens, he said.

"It was very bad law," he said. "It's, to a degree, not logical. We just don't see the benefits of this law."

In the future, firms will decide not to compete for government contracts because of the burden, Palatiello said. Payees will have to increase their costs or stop bidding, Shavell said.

The speakers said the reason for testifying is to get the message out about the law's negative impact. The first step is to assist IRS to change a few things that are less than practical to mitigate the impact of the law in case it is not repealed, Shavell said.

The AGC has been pushing since 2006 for repeal, Turmail said. In June, the group urged its members to call Congress and request repeal.

America's Health Insurance Plans also said it supported repeal of the law in its letter to IRS. If the law is not repealed, AHIP asked IRS to consider a uniform implementation date of Jan. 1, 2014, for all government contract payments that will be subject to the withholding provision.

Momentum Building in Congress? Congress is in control, Palatiello said, so he hopes to build a case with the IRS as to the impact of the law to influence legislative action.

"I feel that the momentum has really built in Congress for repeal and so to the extent that we can estab-

lish in the hearing a record of information about how onerous this is, particularly on small business, and on job creation, then I think it helps that cause," he said.

House Ways and Means Chairman Dave Camp (R-Mich.) announced plans to pursue repeal in March as part of a larger bill that could come to the floor later in the year (41 DTR G-6, 3/2/11). Palatiello and Shavell said Congress is moving closer to repeal as numbers supporting repeal grow.

The hearing is scheduled for Sept. 12 at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Ave. N.W., Washington, D.C.

BY LIZ WHITE

Texts of the ABC Inc., AHIP, and AGC letters are in TaxCore.