

Background on the New 3% Withholding Requirement On All Federal, State and Local Contracts

In May of 2006, the President signed into law a bill known as the HR 4297, the Tax Increase Prevention and Reconciliation Act. The measure was a hodge-podge of small tax provisions, including extension of capital gains tax rates, increased expensing provisions for small businesses and some alternative minimum tax relief. To offset these revenue-negative provisions it also contained sixteen “revenue offset” provisions to make the bill revenue neutral.

The House and Senate had passed differing versions of this measure and, as is normal in such cases, had gone to Conference to work out the differences and come out with a single final bill. When measures go to Conference, the result is supposed to include only provisions that are in the House bill or the Senate bill or a compromise between similar provisions.

A Conference is not supposed to include provisions that were not addressed in either House or Senate versions. However, that is not a hard and fast rule.

In the case of HR 4297, normal Conference procedure was violated with grave consequences for the construction industry. Going into Conference, the House and the Senate versions of the measure contained several provisions that would help contractors and nothing that would have caused contractors any serious problems.

However, coming out of Conference, a provision had been added that had a sweeping and potentially extremely harmful impact on contractors. This provision, which would go into effect in the year 2011, requires a 3% withholding on any payments made to businesses under a contract with a government entity. This is **any** government entity – federal, state or local – not just federal. Every government body with an annual contracting budget of \$100 million or more (not just construction contracting) must withhold 3% from every payment on its contracts.

Since neither the House nor Senate bill had any such language going into Conference, no one was even looking for such a provision in the final measure. There had been no hearings, no basis on the legislative record and no indication of even the likelihood of such action. In fact, business did not find this “little addition” until two weeks after it had been signed into law by the President. At that point, a vast outcry of opposition from business began to grow – an outcry that is still growing today as more and more people discover this “secret” provision.

NECA was among the first to uncover this language and to begin to develop a construction coalition to urge its repeal. Among the first things we needed to know was who originated this provision and why. Despite many contacts with Conference Committee participants and staff, this provision had “no fingerprints” on it. No one would take credit or responsibility for sponsoring it or for authoring it – not a Senator, not a Representative, not a member of the House or Senate Conference Committee staff.

The only intelligence we have gleaned as to where this horrendous provision originated is through unattributable rumor. What we have heard is that Senator Chuck Grassley (R-IA), chairman of the Senate’s tax-writing committee, had been looking for ways to close the “tax gap” to make this entire measure revenue neutral – that is, its enactment would have no net impact on the federal

budget. However, going into Conference, provisions in the measure cost the government \$6 billion more than were offset by revenue-raising provisions.

As we understand it, an unnamed Republican Conference Committee staff member came up with this provision as a way to generate a windfall of \$6 billion to cover that "tax gap." However, no names have been named, and all the Senators and Representatives from the Conference Committee disavow its authorship.

So what we have is a piece of legislation that would have a devastating impact on construction contractors...legislation with no author, no sponsor, no justification and no hearings...but that is already signed into law!

NECA, most of the rest of the construction industry, many other businesses and trade organizations, and even state and local governments who would have to pay dearly for administering this measure, have formed coalitions supporting repeal. Our champion for repeal in the Senate is Sen. Larry Craig (R-ID) and in the House it looks like it will be Rep. Wally Herger (R-2-CA).

Groundwork is going on right now to develop support for repeal in the next Congress – hopefully long before the January 1, 2011 effective date. Repeal of this provision is at the top of NECA's legislative action list for the next Congress. We will continue to keep you informed.
