



DAVID A. RAYMOND
PRESIDENT & CEO

February 27, 2009

Mr. A.G. Kelley
Office of the Associate Chief Counsel
Internal Revenue Service, Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: CC:PA:LPD:PR (REG-158747-06)

Dear Mr. Kelley:

On behalf of the American Council of Engineering Companies (ACEC) – the national voice of America’s engineering industry – I am writing to express our opposition to the sweeping new requirement under IRC Section 3402(t) mandating that federal, state, and local governments withhold three percent from payments for goods and services. ACEC and a large coalition of affected parties are working with Congress to repeal this burdensome and ineffective provision.

ACEC members – numbering more than 5,700 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. The new requirement will hamper their good work on behalf of the public.

The law, which was recently modified to take effect in 2012, will cover almost all 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 engineering companies that receive contracts or other forms of government payments. In the engineering industry, the average taxable income from a contract is less than three percent of the gross amount of the contract, so for most companies this withholding will cut into funds needed to complete the contract and would create serious cash flow problems. While the provision was designed to deter tax evasion, it will clearly penalize honest taxpayers such as the member firms of ACEC and create hardships for companies that contract with governmental agencies.

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In April 2008, the Department of Treasury issued a request for public comments as it prepared to draft proposed regulations to implement the three percent withholding requirement. ACEC submitted comments at that time and outlined several areas of concern. In writing the proposed regulations, Treasury did address a few issues that ACEC raised.

The proposed regulations exempt substantially all payments of less than \$10,000 from the withholding requirement. This *de minimis* threshold will reduce one layer of complexity introduced by the withholding law, and ACEC supports this element of the proposed regulations.

In addition, the proposed regulations exempt existing contracts from the withholding requirement, unless the contract is materially modified. Attempting to impose three percent withholding on a contract that had been negotiated and awarded prior to implementation of the law would have significantly complicated completion of the contract. ACEC agrees with this exemption from the withholding requirement, and asks the IRS to provide a clear, comprehensive definition of what constitutes a material modification.

However, the proposed regulations fail to address several significant issues. Treasury has indicated that it heard from numerous affected parties who asked that they be permitted to credit withheld amounts against estimated income taxes and other federal taxes, such as payroll taxes. The proposed regulations only allow crediting withheld amounts against income taxes. As noted earlier, in the engineering industry the average taxable income from a contract is less than three percent of the gross amount of the contract, the amount that will be withheld under Section 3402(t). Consequently, quarterly estimated income taxes will only offset part of the withholding and the remainder must be drawn from resources that firms need to complete the contract.

This excess tax withholding will create cash flow problems for both large and small businesses. Most businesses would attempt to obtain loans to bridge this gap. This would increase operating costs through the interest paid on these loans. Interest costs are not an allowable expense under the Federal Acquisition Regulations and cannot be built into the cost of a government contract.

In addition, ACEC assumes that owners and partners of passthrough entities will be allowed to adjust their estimated income tax payments to offset the three percent

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withholding. However, administering this will be quite challenging for both the IRS and the passthrough entities.

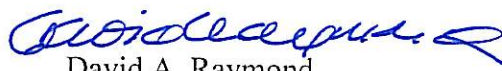
The narrative accompanying the proposed regulations states "Consistent with the statute's purpose of addressing income tax noncompliance, the Treasury Department and IRS propose to allow credits to be claimed only against income tax." ACEC requests clarification as to whether this refers only to the business entity's income taxes, or also to the income tax withholdings from employees that are remitted to the IRS.

The proposed regulations clarify that the three percent withholding applies to contracts between a government entity and a prime contractor, but does not apply to any subcontracts executed by the prime contractor. However, even this application of three percent withholding will complicate the relationship between prime contractors and subcontractors. Many prime contractors work with subcontractors in part to meet small business contracting targets that are established by the federal government. They may also be governed by state prompt pay laws. The interaction of these two mandates means that a prime contractor could be required to hire subcontractors but would not be allowed to pass the withholding along to the subcontractors, and would have to absorb the entire cash flow impact. In cases where a prime contractor is permitted to pass the three percent withholding through to its subcontractors, the record-keeping burden will increase substantially.

Finally, implementation of the three percent withholding requirement will impose significant costs on businesses and governments alike. Federal agencies and state and local governments will have to devote scarce resources to tracking and remitting the funds to Treasury. For example, the Department of Defense has estimated that it will cost DOD over \$17 billion in the first five years to implement the systems needed for collecting and remitting the withheld funds.

Implementation of the three percent withholding requirement will burden the honest taxpayers who comprise ACEC, as well as other firms across the spectrum of the U.S. economy. The costs of implementing this provision far outweigh the negligible tax revenues that will be collected, and ACEC strongly supports its repeal and replacement with more appropriate, targeted measures.

Sincerely,

A handwritten signature in blue ink, appearing to read "David A. Raymond", with a stylized flourish at the end.

David A. Raymond
President & CEO