



THOMAS N. HENLE, CPA  
KARL E. SCHUNCK, CPA  
MICHAEL R. HUHN, CPA

CRAIG A. CLEVELAND, CPA  
JAMES F. KEPKE, CPA

AN ACCOUNTANCY CORPORATION

## Contractors Fight 3% Withholding Tax

Contractors nationwide are preparing to fight back against a law\* that will require federal, state, and local governments to withhold 3% from all payments for goods and services. The 3% tax, slated to become operational in 2011, is intended to guard against possible tax evasion by businesses.

With certain exceptions, the law requires 3% withholding on all government payments for products and services made by all branches of government and their instrumentalities (including multi-state agencies). The law will affect payments for goods and services under government contracts and payments to any person for a service or product provided to a government entity.

### The New Law's Ramifications

The construction industry argues that it would be particularly hard hit by this new withholding tax and objects to its imposition on several grounds. According to the Associated General Contractors of America:

- The government will essentially be withholding funds required to complete a project since the withholding applies to the total contract and not to the net revenue that a project generates.
- The amount of the withholding will be equal to or greater than the profit on many construction projects since general contractors, especially those working as construction managers, do not typically make 3% profit on a contract.
- Federal law requires construction contractors to carry several types of bonds. Typically, surety companies examine a contractor's cash flow before opting to cover a contract. The new law will restrict cash flow for many contractors, which, in turn, will affect the ability of contractors to acquire bonding. Many contractors may end up paying higher-than-normal premiums simply to acquire bonding, while others may be denied coverage. Current laws require corporations to make quarterly estimated tax payments toward their income-tax liabilities. In view of this requirement, the imposition of an additional withholding tax is an unnecessary burden.
- S corporations and joint ventures would face additional reporting since withholdings need to be accounted for and reported to each shareholder or partner. This increased reporting burden may end up reducing the number of entities willing to take on large government projects.

We will keep you updated on any further developments as they relate to this new law.

\* The Tax Increase Prevention and Reconciliation Act of 2005, Section 511, which amended Internal Revenue Code Section 3402(t).

**“... the law requires 3% withholding on all government payments for products and services ...”**

### JONES, HENLE & SCHUNCK STRATEGIC ACCOUNTING ADVISORS

135 TOWN & COUNTRY DRIVE P.O. BOX 9500 DANVILLE, CALIFORNIA 94526  
ph (925) 820-1821 fx (925) 820-8266 danville@jhs.com www.jhs.com  
DANVILLE • ORANGE