



February 25, 2009

Mr. Douglas Shulman
Commissioner
CC:PA:LPD:PR (REG-158747), Room 5205
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, D.C. 20044

Rulemaking Portal: <http://www.regulations.gov/>
(IRS REG-158747-06)

Re: Proposed IRS Rule regarding Section 511 of P.L. 109-222 (Withholding Under IRS Code Section 3402(t)) should positively assert no withholding pass-through to subcontractors.

Dear Mr. Shulman:

The undersigned groups of the Campaign for Quality Construction submit the following comments on the proposed regulations relating to withholding under Internal Revenue Code section 3402(t) as published in the Friday, December 5, 2008 Federal Register (page 74082). We should note that the groups are vigorously opposed to the three percent withholding law and will continue to press for complete repeal of Section 511 of Public Law 109-222 which mandates the impractical requirement that federal, state and local governments withhold three percent of their payments for goods and services.

Correct Ambiguity Between Preamble and Rule Language

We support unequivocally the IRS's recognition in the preamble to the proposed rule that the public law did not envision prime contractor tax liability withholding pass-through to subcontractors, as the law addresses only the tax liability of prime contractors.

The IRS notice says, at 73 FR 74085: "...if a government entity enters into a contract with a prime contractor for property and services, and that prime contractor separately contracts with subcontractors for delivery of certain property and services, then withholding under section 3402(t) applies only to payments by the government entity or its payment administrator to the prime contractor, and does not apply to successive payments by the prime contractor to its subcontractor."

Despite the clarity of the preamble, the actual regulations have a remaining ambiguity that must be corrected. Section 31.3402(t)(d)(2), defines "payments to a contractor," as follows; "If a person provides property or services to a government entity under a contract and is not a payment administrator, the person, who is in privity with the government entity, is treated as the person providing property or services subject to withholding under section 3402(t) for all payments received from the government entity, regardless of whether some payments the person receives relate to invoices for property or services provided by subcontractors."

Strictly construed, the paragraph merely defines how the prime contractor qualifies for withholding -- irrespective of subcontract amounts. But, because of this ambiguity, it is subject to misinterpretation. A positive assertion that pass-through of withholding is prohibited is fully in accord with the withholding statute (Section 511 of P.L. 109-222), which addresses only the direct revenue and tax liability of the prime contractor. Furthermore, we assert that any contrary view also would contravene the Federal Prompt Payment law and any other applicable public contracting statute or regulation designed to address public contracting payment abuses. (See, Federal contract FAR clause 52.232-27, Prompt Payment for Construction Contracts.) Payments for subcontract work are not revenue to the prime for which tax liability accrues to the prime contractor, and against which the withholding is intended to apply. Put another way, payment to subcontractors are outside the scope of Section 511 withholding.

The IRS should add a specific amendment in the Section 31.3402(t)((d)(2) clarifying that the prime contractor may not pass-through any of that withholding to subcontractors under the prime contract or subcontract arrangement, as the Federal prompt payment rules only permit withholding for performance-related cause, and any such withholding would exceed the explicit reach of Section 511 as well.

Payments to Subcontractors Are Not Covered by the Law

The IRS notice, at 73 FR 74085 in the proposed rule does not clearly say whether the amounts of any prime contract invoice that are payable to subcontractors either are or are not subject to withholding even though the law clearly applies only to the tax liability of prime contractors. Because the law applies only to the direct revenue and tax liability of the prime contractor, the undersigned contractor groups urge the IRS to clarify proposed Sections 31-3402(t)-3(b)(2) and (d)(2) to emphasize that while the \$10,000 threshold applies to the overall value of a covered invoice, the basis amount of the withholding is only the amount of that invoice that is payable to the covered prime contractor - not any amount payable to subcontractors. So, for example, a prime construction contract monthly payment invoice is for \$100,000, but \$90,000 of that is payable for subcontractor work. Then the \$100,000 invoice would be gross revenue to the prime, against which the subcontractor payment of \$90,000 would be an expense deduction, leaving net revenue of \$10,000. Therefore the only amount for which the prime would have ultimate tax liability would be \$10,000 and the 3% withholding should be only on the \$10,000. Contracting officers would have the responsibility to delineate at payment schedules how much of a payment application is going to subcontractors. (See, Federal construction contract payment clause FAR 52.232-5, Payments under Fixed price Construction Contracts.)

Publish Final Rule Expediently

In closing, CQC emphasizes its view that the entire Section 511 scheme is hugely counterproductive, and very unsound procurement policy. We are continuing to work in a broader coalition with many public and private contracting policy groups to gain repeal in time to save the vast administrative waste entailed in gearing up to implement the law in 2012. Until then, we will continue to work with the IRS in seeking to minimize the harm the proposal would wreak. Also, we would ask IRS to implement these changes and others very expediently, publish a final rule quickly, so that Congress can then reassess the "score" on the misguided provision more accurately and lay the ground work for necessary and timely repeal. CQC also urges IRS to conduct a broader cost-benefit analysis of the proposal, as there is mounting

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widespread evidence that the administrative costs and project financing and other associated costs of the measure dwarf any narrowly assessed perceived gain to the Treasury.

Our construction industry alliance is composed of the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), the Mechanical Contractors Association of America (MCAA), The Association of Union Contractors (TAUC), the Finishing Contractors Association (FCA) and the International Council of Employers of Bricklayers and Allied Craftworkers (ICE-BAC).

These combined groups represent over 24,000 member companies in the highly skilled specialty sector of the construction industry. Specialty construction comprises 64% of the construction industry workforce, with some 3.9 million employees out of total employment of 6.2 million workers combined in specialty, residential, and heavy construction trades.

Sincerely,

[John McNerney](#), Director, Government Relations
[Mechanical Contractors Association of America, Inc.](#)
1385 Piccard Drive, Rockville, MD 20850-4340
(301) 869-5800 Phone (301) 990-9690 Fax

[Stanley E. Kolbe, Jr.](#) Director, Legislative Affairs
[Sheet Metal and Air Conditioning Contractors' National Association, Inc.](#)
P.O. Box 221230, Chantilly, VA 22022-1230
(703) 803-2980 Phone (703) 803-3732 Fax

[Todd Mustard](#) Executive Director of Association Services
[The Association of Union Constructors \(TAUC\)](#)
1501 Lee Highway, Suite 202 Arlington, VA 22209-1109
(703) 524-3336 ext. 112 Phone (703) 524-3364 Fax

[Jay Weaver](#) Executive Director Industry Services
[Finishing Contractors Association](#)
8150 Leesburg Pike, Suite 1210 Vienna, VA 22182
(703) 448-9001 Phone (703) 448-9002 Fax

[Matthew S. Aquiline](#) Executive Director
[International Council of Employers of Bricklayers & Allied Craftworkers](#)
P.O. Box 21462, Washington, DC 20009
202-210-6069 Phone (202) 457-9051 Fax