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AGC of America
THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
Quality People. Quality Projects.



April 15, 2013

The Honorable Vern Buchanan
Chair, Small Business Working Group
House Ways & Means Committee
2104 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Allyson Schwartz
Vice Chair, Small Business Working Group
House Ways & Means Committee
1227 Longworth Building
Washington, DC 20515

Re: Comments of the Associated General Contractors of America for the Small Business/Pass-throughs Tax Reform Working Group of the Ways and Means Committee

Dear Representatives Buchanan and Schwartz:

The Associated General Contractors of America (AGC) commends the thoughtful progress that Chairman Camp, Ranking Member Levin, and the Members of the Ways and Means Committee are making towards comprehensive tax reform and welcomes the opportunity to comment on areas relating to small businesses as pass-through entities. As leaders of the Small Business/Pass-throughs Tax Reform Working Group, AGC appreciates your efforts in soliciting feedback from stakeholders of all sizes on the difficulties faced when wading through the IRS rules and regulations, as well as the complexities of the Internal Revenue Code (IRC).

AGC is the leading association in the construction industry. Founded in 1918 at the express request of President Woodrow Wilson, AGC now represents nearly 30,000 leading firms in the construction industry through a network of 95 chapters throughout the United States. AGC members engage in the construction of buildings, shopping centers, factories, industrial facilities, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, hospitals, water conservation projects, defense facilities, multi-family housing projects, municipal utilities and other improvements to real property.

AGC members are engaged in all forms of nonresidential construction and consist primarily of small businesses with the vast majority of our members (typically more than 70 percent when surveyed) organized as pass-through entities. When our members discuss tax reform they gravitate towards simplicity and permanency as being critical to tax policy. With a critical element of permanency being the indexing of income thresholds so that inflation is not the cause of tax policy changes.

While AGC and its membership continue to analyze the latest discussion draft released by the Ways and Means Committee on small businesses and pass-through entities; AGC would like to provide the following commentary on the impact of selected proposals on our construction company members and offer other areas for consideration.

Small Business Provisions

179 Expensing

While ATRA allows Section 179 expensing levels to increase to \$500,000, the limit on what a business can deduct is slated to decrease to a meager \$25,000 in 2014. AGC supports Chairman Camp's discussion draft provisions regarding the permanent nature of the Section 179 expensing of new equipment and property up to \$250,000 phasing it out at \$800,000 and indexing the amount to inflation. AGC continues to study the impact on the construction industry of phasing-down from the \$2,000,000 to \$800,000 level.

S-corporation Elections

AGC is supportive of the provision in the discussion draft to simplify the procedure and extend the time for making an S corporation election, permitting a corporation to make the election on its first tax return.

Expansion of Cash Accounting & AMT Relief

AGC is amenable to the provision in the discussion draft to replace the current tax-accounting rules that apply to small businesses with a uniform rule under which all businesses with gross receipts of \$10 million or less may use the cash method of accounting. Moreover, AGC suggests that relief from the Alternative Minimum Tax (AMT) for small businesses should be increased from \$7.5 million to \$10 million and indexed for inflation in order to align the two thresholds for construction companies engaged in long-term contracts.

In addition, we recommend making two changes to current law that could provide additional flexibility and simplicity to construction industry tax compliance.

Percentage-of-Completion Accounting

AGC advocates that there should be an increase of the threshold at which the percentage-of-completion method of accounting is required. The Tax Reform Act of 1986 revised the long-term contract accounting rules for contractors in Section 460 of the IRC. Currently, a contractor whose contracts will be completed within two years of the contract commencement date, and whose average annual gross receipts for the three tax years preceding the tax year the contract is entered into do not exceed \$10 million, is exempt from the percentage of completion requirements.

AGC believes that Section 460 places an unfair burden on smaller construction companies. Prior to the 1986 Act, a contractor could pay taxes on their income from a long-term contract when the contract was completed. Congress clearly recognized the burden this change places on smaller contractors forced to switch to the percentage-of-completion method and created the exemption.

Today, more and more small contractors are crossing this threshold and are being forced into the burdensome and costly percentage-of-completion method. AGC suggests that the \$10 million exemption be raised to \$25 million and indexed to inflation.

Look-back Accounting

The Tax Reform Act of 1986 revised the long-term contract accounting rules for contractors. These rules – contained in Section 460 of the IRC – require a construction contractor to file amended tax returns for every prior year in which a currently completed contract was in progress. For small and mid-size contractors, look-back computations are very complex and expensive, requiring inordinate amounts of time, resources and accounting fees to comply, with the results usually being confusing and immaterial to both the government and the taxpayer. Since this process is pushed down to the individual shareholder level, a company must go through each individual's returns to make the interest computation. These recalculations can go back a number of years. In the end, the same tax is typically paid.

Currently, Section 460(b)(3)(B) provides an exemption from the look-back rules for contracts which are completed within two years and for which the contract price does not exceed the lesser of \$1,000,000 or 1 percent of the average gross receipts of the taxpayer for the three preceding years. A legislative change to exempt long-term contracts spanning 36 months at a \$25,000,000 threshold would exempt a significant percentage of the small and mid-size construction contracts currently subject to look-back. According to AGC data, approximately 95 percent of construction contracts are completed in two years or less. For construction companies, most contracts are fulfilled in under 36 months.

AGC believes that a legislative change exempting closely-held pass-through entities under a 36 month timeframe would significantly reduce the compliance burden on these taxpayers by averting thousands of dollars spent on tax practitioners to make the interest calculations; as well as diminish the enforcement burden for the Internal Revenue Service, with no measurable effect on revenue. AGC advocates that this modification to lookback accounting should encompass business of all sizes and tax structures to include pass-throughs, as well as C-corporations.

Employment Taxes

There have been a number of proposals put forth to address the treatment of employment taxes currently afforded to pass-through entities. S-corporation flow-through income has historically had an employment tax advantage over that of sole proprietorships, partnerships and limited liability companies (LLCs). An S-corporation shareholder's undistributed share of S corporation income is not treated as self-employment income. Alternatively, earnings attributed to a sole proprietor, general partner or many LLC members are subject to self-employment taxes; although Section 1402 excludes from self-employment income a limited partner's distributive share of partnership income. Some proposals that have been introduced would eliminate that exclusion for any partner with a higher adjusted gross income.

AGC believes that proposals to modify or unify rules for pass-through entities should be fully vetted by the Ways and Means Committee in an open and transparent manner with continued significant input from stakeholders. A rash attempt to treat taxation of S-corporation shareholders the same as partnerships, thus exposing 100 percent of earnings to a potential Social Security or Medicare tax would be a significant departure from the current structure of these entities and it would distort the tax liability of certain corporate structures.

Deduction for Energy Efficient Commercial Buildings

AGC continues to observe significant utilization of Section 179D deductions being allocated from government projects to the design architects, engineers and certain contractors. The agencies are increasing their confiscation of the benefits by requiring a payment from the designing firm prior to assigning the deduction – clearly this was not the intent of the law. Many small businesses are being impacted by this process. AGC recommends that the Committee study a change to this provision that either prohibits or limits the collection of funds by the assigning agency to encourage the design of energy efficient government properties and provide a beneficial tax environment for the firms who engage in the planning and construction.

Permanency of Withholding

AGC is concerned with the permanent nature of the entity-level withholding requirement. Many times, there can be a taxable loss in one pass-through entity that will offset the taxable income of another pass-through entity. This provision could stymie cash flow on an overall basis. AGC recommends that there be an “opt-in” option for businesses rather than mandatory withholding.

Predictability for Business Operations

AGC appreciates the efforts by Congress to provide a significant amount of certainty to its membership through the passage of the American Taxpayer Relief Act (ATRA). The legislation that was signed in to law to avert the 2012 fiscal cliff permits companies to plan with the greater confidence that comes from cost predictability. AGC is particularly pleased with the permanent extension of the 2001 and 2003 tax cuts for 98 percent of Americans.

AGC is also appreciative for the certainty provided for marginal rates for long-term capital gains and dividends set at 15 percent for earnings below \$400,000 (\$450,000 for joint filers) and 20 percent taxable incomes above the aforementioned amounts; as well as the increase in the Alternative Minimum Tax (AMT) exemption amount, exemption phase-out threshold, and indexing for inflation.

Another priority for AGC members is the planning for transfer of ownership after the passing of an owner. ATRA allows family-owned businesses within the AGC membership to focus on growth and business planning; which would grow our economy, create new jobs, and strengthen businesses. For this reason, AGC is gratified for the reasonable, permanent reform provided under the new law with a 40 percent tax rate for estates above the exemption value of \$5 million indexed for inflation (\$5.25 million for 2013).

Comprehensive Reform for Both Entities

AGC believes that Congress should continue the dialogue of comprehensive tax reform at both the individual and corporate levels simultaneously. The individual and corporate codes are not mutually exclusive and they must be reformed while discussing the reactionary affect a policy change would have on each other structure. Pass-through entities account for some 90 percent of businesses, employ more than 50 percent of the private sector workforce and report more than a third of all business receipts. Like corporations, pass-through organizations face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6 percent, even higher than the anti-competitive 35 percent rate faced by C-corporations.

Moreover, changes to the IRC under the Patient Protection and Affordable Care Act (PPACA) only exacerbate the tax burden on pass-through businesses. The law increases the Medicare Part A (hospital insurance) tax rate by 0.9 percent on unearned income on earnings over \$200,000 for single filers or \$250,000 for joint filers, and imposes a 3.8 percent tax on investment income for taxpayers with a modified adjusted gross income (MAGI) exceeding \$200,000 for single filers or \$250,000 for joint filers. Including the healthcare tax increase, marginal rates will be set at 40.5 percent for individuals earning over \$400,000 and 40.5 percent for joint filers earning over \$450,000.

If Congress ultimately pursues a reform that eliminates deductions and credits for a lower corporate rate, many small businesses would experience an increase in the income taxes paid as individual owners of a pass-through business. For the aforementioned reasons, AGC strongly recommends that tax reform be pursued comprehensively, addressing both individual and corporate tax rates simultaneously.

Conclusion

AGC thanks the Members of the Small Business Working Group for the opportunity to submit comments on areas regarding small business/pass-throughs during this period of fact-finding for comprehensive tax reform. We believe strongly that an overhaul of the IRC must deal with all business structures similarly and contemporaneously. We believe that simplicity and certainty should be the goal of tax reform and that provisions in the existing code that create a compliance nuisance with little or no change in tax liability should be eliminated especially for small businesses.

AGC looks forward to ongoing consultation with Congress, the Committee, and Members of the Working Groups as this process continues to make improvements to the code in order to create an atmosphere that is increasingly pro-business and pro-growth.

Sincerely,



Jeffrey D. Shoaf
Senior Executive Director
Government Affairs

Cc:
Chairman Dave Camp
Ranking Member Sander Levin
The Honorable Aaron Schock
The Honorable Todd Young