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



April 15, 2015

The Honorable John Thune, Co-Chair
Senate Committee on Finance
Business Income Tax Working Group

The Honorable Benjamin Cardin, Co-Chair
Senate Committee on Finance
Business Income Tax Working Group

Re: Tax Reform Working Group Stakeholder Comments

Dear Co-Chairs Thune and Cardin:

The Associated General Contractors of America (AGC) appreciates the ongoing efforts in the Senate Finance Committee toward addressing tax policies that are critical to the construction industry. AGC is the leading association in the construction industry. Founded in 1918, AGC represents nearly 25,000 leading firms in the construction industry 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) organized as pass-through entities. When our members discuss tax reform they gravitate towards simplicity and permanency as being critical to tax policy that will help construction businesses grow. With a critical element of permanency being the indexing of income thresholds so that inflation is not the cause of policy changes in the Internal Revenue Code (“tax code”).

While the industry continues to gradually recover under improving market conditions, the inconsistent tax policy coming from Washington creates an unfavorable investment climate for long-term investment decisions that prohibits more employment, safer infrastructure, and direct economic growth in our communities. As the Working Group prepares findings on current tax policy and legislative recommendations, AGC respectfully urges you to include the following construction industry related provisions that contribute to job creation, capital formation, and long-term investment:

- Marginal rates for pass-through entities and C-corporations
- Estate Taxes
- Capital Gains and Dividends
- ACA Investment Tax
- AMT Relief
- Percentage-of-Completion Requirements
- Look-Back Accounting
- Taxation of Income in Dispute
- Research and Development Tax Credit

- Like-kind Exchanges
- Built-In Gains
- Net Operating Losses
- Depreciation Policy
- Domestic Production Activities Deduction
- Work Opportunity Tax Credit

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 tax 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 95 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 tax 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.

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 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.

AGC continues to oppose the 3.8 percent tax included in the Affordable Care Act that applies to net investment income for individuals earning more than \$200,000 and couples earning more than \$250,000. With the surtax, individuals with income greater than \$400,000 (\$450,000 married couples) will pay a top dividends and capital gains tax rate of 23.8 percent.

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 ATRA with a 40 percent tax rate for estates above the exemption value of \$5 million indexed for inflation (\$5.43 million for 2015).

AMT Relief & Accounting Provisions

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, AGC

recommends making the following changes to current law that could provide additional flexibility and simplicity to construction industry tax compliance:

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 \$40 million and indexed to inflation.

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 \$40 million 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 look-back accounting should encompass business of all sizes and tax structures to include pass-throughs, as well as C-corporations.

Additionally, AGC advocates for a halt in the taxation of income while in dispute. Businesses reporting using the percentage-of-completion accounting method for long-term contracts should be required to include in the contract amount only items for which the “all events test” has been met. The construction industry is the only industry that has been singled out with taxation prior to an economic transfer of value.

Capital Investments & Cash Flow Measures

AGC supports a permanent and expanded research and development (R&D) credit for construction companies that have an increasing responsibilities to innovate products and processes in order to secure successful bids on potential projects. Over the years, the construction industry has moved toward using innovative construction materials to create higher-performing, more reliable, energy-efficient, higher-quality structures. Customers, architects, and engineers continue to raise the bar on innovation such as HVAC systems and large-membrane filtration systems for water treatment plants; and this drives the expectation for contractors to develop new processes and engineering solutions – activities that qualify for the R&D credit.

Examples include: a company contracted to build a bridge next to and over an environmentally protected area that required developing a new construction method that necessitated engineering calculations and a process of experimentation involving various alternatives for cantilevered bridge work; and a design-build contractor implementing creative solutions to retrofit a silo complex for its construction and seamless operations.

AGC supports the current treatment of like-kind exchanges under section 1031 of the tax code and opposes any policies to limit or repeal the provision in the tax code. Like-kind exchanges facilitate the ability of taxpayers to exchange their property for more productive like-kind property, to diversify or consolidate holdings, and to transition to meet changing business needs. Without like-kind exchanges, businesses and entrepreneurs would have less incentive and ability to make real estate and capital investments since the immediate recognition of a gain upon the disposition of property being replaced would impair cash flow and could make it uneconomic to replace that asset. As a result, requiring the recognition of gain on like-kind exchanges would hamper the ability of businesses to be competitive in our global marketplace. The reduced investment in real estate and capital would also have significant upstream and downstream impacts in industries as diverse as real estate, construction, tourism, and equipment supply.

Unlike public corporations, closely-held construction firms have little or no access to the capital markets. Instead they rely on banks, relatives, and their own savings to fill their investment and working capital needs. An overly long built-in gains recognition period makes this disadvantage worse by preventing companies that have chosen to become S-corporations from accessing their own capital and putting it to better use. Locking up a company’s capital for an entire decade is simply unreasonable. Past Congresses have recognized that a decade is too long and voted to reduce the recognition period on three separate occasions, but those temporary measures have expired and the 10-year rule is back in effect. AGC supports a permanent shorter recognition period would sustain the original intent of the rule while providing S corporations with much needed certainty.

AGC supports creation of permanent tax policy on net operating losses (NOL) that allows a 5-year carryback and a 15-year carryforward for all businesses to allow cash-strapped businesses to convert future tax benefits into cash today.

AGC believes any provisions that would tax carried interest at higher rates that would undercut the economic incentive to build projects and drive away investments from the commercial real estate sector. Most efforts identified have cast a broad net and will likely have a significant impact on equity transfer in closely held construction companies, as well as have a devastating and punitive impact on commercial real estate developers who use carried interest as the investment model for creating successful real estate projects.

Business Expensing

Construction companies must take a long-term view of the repair-rebuild-replace decisions in order to optimize the value of equipment assets over their full life cycle. Depreciation policy has allowed for many construction firms to take advantage of this tax deduction to purchase new equipment to replace antiquated machinery, and or meet new safety and emission standards. AGC supports expanding and making permanent bonus depreciation and enhanced capital expenditures write-offs to incentivize capital investments and allow for the purchase of modern equipment. While the American Taxpayer Relief Act (ATRA), and the more recent Tax Increase Prevention Act of 2014, allowed for a one-year retroactive extension of Section 179 expensing levels to increase to \$500,000, the limit on what a business can deduct has decreased to a meager \$25,000 in 2015. AGC supports the expanded levels and permanency for Section 179, as well as indexing the thresholds to account for inflation.

In addition, general and specialty contractors are involved with customized alterations a building owner makes to rental space as part of a lease agreement. These leasehold improvements include changes to certain walls, floors, ceilings, and lighting, efficiency improvements to heating and cooling systems, as well as electrical/plumbing systems, including sprinklers. In actual practice, these customized tenant improvements usually have a useful economic life of 5 to 10 years, which spans the average commercial lease term. For several years, Congress has recognized that the economically useful life of most leasehold improvements is much shorter than the applicable 39-year depreciation period. AGC supports making the 15-year qualified leasehold improvement depreciation a permanent provision in the tax code to provide an important incentive for capital improvements to these properties.

AGC supports preservation of the Domestic Production Activities Deduction (Section 199) for the construction industry. The DPAD is a valuable provision for AGC member companies that engage in construction projects that involve commercial buildings, docks, wharves, parking lots, oil and gas wells, platforms and pipelines, roads, sewers, and power lines assuming they add material value, prolong useful life or adapt a real property for new or different use.

Workforce Development

AGC supports extension of the Work Opportunity Tax Credit (WOTC) which provides a benefit to employers for hiring groups facing high rates of unemployment, such as veterans, youths, individuals receiving disability rehabilitation, and residents of empowerment zones or rural renewal counties.

Utilization of WOTC has substantially increased in recent years as Congress has introduced new target groups, expanded several target groups' requirements, increased the tax credit and the qualified wages for veterans and introduced new flexible filing provisions. WOTC helps these targeted groups obtain employment so they are able to gain the skills and experience necessary to obtain better job opportunities.

Conclusion

AGC thanks the members of the Working Group for the opportunity to submit comments on areas regarding construction firms during this period of fact-finding. We believe strongly that an overhaul of the tax code 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 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 for the construction industry and the over 6.3 million American workers who benefit from direct or indirect employment.

Sincerely,



Jeffrey D. Shoaf
Senior Executive Director
Government Affairs

Cc: The Honorable Pat Roberts, Member, Business Income Tax Working Group
The Honorable Debbie Stabenow, Member, Business Income Tax Working Group
The Honorable Richard Burr, Member, Business Income Tax Working Group
The Honorable Tom Carper, Member, Business Income Tax Working Group
The Honorable Johnny Isakson, Member, Business Income Tax Working Group
The Honorable Bob Casey, Member, Business Income Tax Working Group
The Honorable Rob Portman, Member, Business Income Tax Working Group
The Honorable Mark Warner, Member, Business Income Tax Working Group
The Honorable Pat Toomey, Member, Business Income Tax Working Group
The Honorable Robert Menendez, Member, Business Income Tax Working Group
The Honorable Dan Coats, Member, Business Income Tax Working Group
The Honorable Bill Nelson, Member, Business Income Tax Working Group