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July 17, 2017

The Honorable Orrin Hatch
Senate Committee on Finance, Chairman
United States Senate
Washington, D.C. 20510

Dear Chairman Hatch:

The Associated General Contractors of America (AGC) appreciates your ongoing efforts in the Senate Committee on Finance toward comprehensive tax reform that is critical to the construction industry. AGC is the leading association in the construction industry, representing over 26,000 leading firms. AGC members are engaged in all forms of nonresidential construction and consist primarily of small businesses, with the vast majority of our members organized as pass-through entities. In response to your request for comments from tax reform stakeholders, AGC would like to submit these recommendations.

When AGC members discuss taxes, they gravitate towards simplicity and permanency as being instrumental for helping construction businesses grow. The inconsistent tax policy coming from Washington creates an unfavorable investment climate for long-term investment decisions that hinders job creation, the construction of safer infrastructure, and direct economic growth in our communities. AGC respectfully urges you to consider the following pro-growth policies, as they have a demonstrated capability to create jobs, protract capital formation and increase long-term investment for the construction industry and its customers.

Additionally, during the debate of a comprehensive rewrite of the tax code, Congress must not pick winners and losers; therefore, any corporate tax reform must address all types of C-corporations and pass-through entities simultaneously. If Congress can substantially reduce rates, we support giving up tax incentives that currently reduce the effective tax rate of our member companies, which at 30.3 percent is one of the highest among any industry.

AMT Relief & Accounting Provisions

AGC supports repeal of the Alternative Minimum Tax (AMT) for corporations and individuals. Short of full repeal however, AGC suggests that relief from the AMT for small corporations 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 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 Internal Revenue Code (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 also 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 several 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 million 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.

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 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.

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.

Any provisions that would tax carried interest at higher rates undercuts the economic incentive to build projects and drives 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

AGC supports preservation of the Domestic Production Activities Deduction (Section 199) for the construction industry as currently written and opposes proposed changes by the Treasury to the definition of “substantial renovation.” 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.

Infrastructure Investment & Financing

AGC supports tax-exempt public works financing: as such, any proposals to reduce or repeal the federal tax exemption on municipal bond interest would have harmful impacts on infrastructure development, raising costs for state and local borrowers and creating uncertainty for investors.

Given the success of public-private partnerships (P3s) in the transportation sector, since the passage of SAFETEA-LU in 2005, P3s should be considered as a new way to improve schools, hospitals, labs, courthouses and correctional facilities. The utilization of P3s for public buildings has been limited because unlike the transportation, solid waste, or water sectors, public buildings are not eligible for exempt facility bonds. AGC supports the creation a new category of exempt facility PAB for public buildings that allows private investment to be combined with tax-exempt financing to design, build, finance, and maintain public buildings.

Highway Trust Fund

The United States has been under investing in our transportation systems for far too long and the impact is now being felt in every state. Congress must address the long-term viability of the Highway Trust Fund (HTF) beyond the current reauthorization and solve the HTF dilemma for future generations in need of safe and sufficient infrastructure. As the Committee prepares for an overhaul of the tax code, a sustainable user fee based model for maintaining the HTF must be considered before funding is exhausted at the end of 2018.

There have been proposals introduced or discussed to replace the gas tax with a distance traveled fee or impose a fee on a per-barrel basis. There have also been discussions about an energy extraction fee, energy transmission fee, freight fees and even fees on transit. AGC believes all of these and other policies should be examined fully, because while the primary mode of travel for goods has changed since the First Congress, there is still a strong federal role in making sure that we are economically competitive with the rest of the developed world.

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 the long-term unemployed. Utilizations of WOTC has substantially increased in recent years as Congress has expanded the potential pool of WOTC recipients, 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 looks forward to ongoing consultation with you and your colleagues as the committee moves forward to address policies that affect the construction industry. 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.

Sincerely,



Jeffrey D. Shoaf
Senior Executive Director, Government Affairs