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Statement of Robert Kulp

On behalf of the

National Roofing Contractors Association

House Committee on Small Business

"How Tax Complexity Hinders Small Businesses: The Impact on Job Creation and Economic Growth"

April 13, 2011

Chairman Graves, Ranking Member Velázquez, and distinguished members of the committee, thank you for the opportunity to testify today on behalf of the National Roofing Contractors Association (NRCA) to discuss how tax complexity hinders the ability of small businesses to create jobs. I am Bob Kulp, founder and co-owner of Kulp's Of Stratford LLC, a roofing contractor in Stratford, Wisconsin. I currently serve on the NRCA board of directors and as chairman of the association's government relations committee.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. It is an association of roofing, roof deck, and waterproofing contractors; industry-related associate members, including manufacturers, distributors, architects, consultants, engineers, government agencies and international members. NRCA has approximately 4,000 members from all 50 states and 54 countries. NRCA contractors typically are small businesses, with the average member employing 45 people in peak season and having sales of $4.5 million per year.

Kulp's Of Stratford is involved in both commercial and residential roofing and insulation with an emphasis on metal and thermoplastic roofing systems and interior spray foam installations. We have a specialty metals division that includes fabrication and finishing of projects such as complete steeple structures as well as finials on steeples for churches. We also are now involved with installing Building Integrated Solar Photovoltaic roofing. Kulp's employs between 35-50 people depending on the season and we have about $6 million in annual sales.

As the national unemployment situation continues to slowly improve, unemployment in the construction industry remains at an alarming 20.0 percent, according to the Bureau of Labor Statistics. There appears to be little relief in sight for our industry during these difficult economic times. Clearly, the time is right to take steps to improve this situation, and reducing complexity in the tax code is a good place to start.

Given the continued highly difficult economic conditions in the construction industry, NRCA urges Congress to take immediate action on tax policy measures that will remove impediments and spur job growth within our industry. NRCA strongly supports depreciation reform for commercial roofs, repeal of the three percent withholding tax on government contracts, and the reform of the completed contract method (CCM) of accounting. We believe enactment of these initiatives will reduce and simplify taxes, thus allowing entrepreneurs to create jobs in construction and other industries, particularly among small businesses.

Depreciation Reform

Small businesses within the roofing industry are uniquely positioned to play a critical role in creating jobs for American workers. Congress should facilitate the creation of an estimated 40,000 jobs annually within our industry by passing legislation to reduce the depreciation schedule for commercial roofs from 39 years to 20 years. In addition to creating 40,000 jobs among contractors and manufacturers, such legislation would also enhance the energy efficiency of our nation's commercial buildings and simplify taxes for small businesses in many industries.

Depreciation reform is necessary because between 1981 and 1993 the depreciation schedule for nonresidential property was increased from 15 years to 39 years. However, the current 39-year depreciation schedule is not a realistic measure of the average life span of a commercial roof. A study by Ducker Worldwide, a leading industrial research firm, determined the average life expectancy of a commercial roof to be 17 years.

The large disparity between the 39-year depreciation schedule and the average life span of a commercial roof is a major incentive for building owners to delay the replacement of failing roofs. This is slowing economic activity and the adoption of more advanced energy-efficient roofs, because an owner who replaces a roof before 39 years have elapsed must continue to depreciate that roof for tax purposes even though it no longer exists. A Treasury Department Report to Congress on Depreciation Recovery Periods and Methods confirmed this problem by finding "…a 'cascading' effect, where several roofs are being depreciated at the same time, even though only one is physically present." Given this situation, many building owners choose to do only piecemeal repairs, most often with older technology, rather than replace a failing roof in its entirety with new, more energy-efficient materials.

In the 111th Congress, several bills (H.R. 426 and H.R. 5396) were introduced with bipartisan support to rectify this situation. This legislation would reduce the depreciation schedule from 39 to 20 years for commercial roofs that meet a benchmark energy-efficiency standard. This would facilitate job creation in our industry by accelerating demand for commercial roofs by eliminating the disincentive in the tax code for building owners to delay replacement of failing roofs. Enactment of this legislation would also benefit small businesses of all types by mitigating the “cascading effect” of having to depreciate more than one roof in instances where a roof must be replaced before the 39-year depreciation schedule has been completed.

According to the Ducker Worldwide study, depreciation reform would produce the following benefits by accelerating demand for commercial roofs:

- Create 40,000 new jobs within the roofing industry;
- Add $1 billion of taxable annual revenue to the economy;
- Provide savings to small businesses of all types through a simpler and more equitable system of taxation and lower energy costs; and,
- Reduce U.S. energy consumption by 13.3 million kilowatt hours annually and cut carbon emissions by 20 million lbs. per year.

Depreciation reform for commercial roofs enjoys support of a diverse coalition of businesses, manufacturers, and labor groups. The bill would create jobs not through a special tax incentive, but by the removal of an obstacle in the tax code which restricts economic growth in the construction industry. Additionally, it would help improve property values, thus increasing resources for schools and local authorities.

NRCA is working with a wide array of members to explore opportunities for depreciation reform in the 112th Congress. We welcome the opportunity to work with members of the House Small Business Committee on this issue, which has great potential to create jobs among small businesses in the construction industry.

<u>Three Percent Withholding Tax on Government Contracts</u>

NRCA calls for the immediate repeal of the three percent withholding on government contracts mandated in Section 511 of the *Tax Increase Prevention and Reconciliation Act of 2005* (TIPRA) through the prompt passage of the Withholding Tax Relief Act of 2011 (H.R. 674). Repeal of the withholding law, which adds a new layer of complexity to a contractor’s tax filing, is vital to job creation and economic growth in the roofing industry.

If the withholding law is not repealed, roofing contractors performing government work will face serious repercussions. The mandated three percent of the contract that is withheld is taken off the total value of that contract, not the profit earned on the project. Given that three percent or less of the total contract is the average profit margin in our industry, withholding could eliminate contractors’ profits on many projects, thus severely limiting the ability of contractors to grow their business and create jobs.

While the contractor may collect the three percent that is withheld at the end of the year, cash-flow and operating capital disruptions caused by withholding will be a tremendous burden, particularly for small businesses. The bookkeeping systems of many small businesses are not set up to account for such large amounts withheld from invoices. Withholdings will also complicate tax filings and the need to accurately determine tax liability, especially since tax software has not been developed in this area. This new complexity will create added compliance costs on businesses and thus will further impair efforts to create jobs. Many roofing contractors will be forced to stop bidding on government contracts in order to avoid these added complexities. Also, contractors continuing to perform government work may be forced to pass additional costs created by withholding along to the government and taxpayers.

The Government Withholding Relief Coalition, of which NRCA is a member, recently released a cost impact study of the three percent withholding law. The study estimates implementation costs for federal, state, and local governments to be about $20.2 billion over five years. Given that the Joint Committee on Taxation estimated in 2006 that the withholding tax will raise roughly $7 billion over five years, it does not make good fiscal sense to allow the withholding requirement to take effect, even from the point of view of the government.

NRCA *strongly* urges Congress to quickly repeal this requirement, which further complicates the tax filing of contractors and stifles job creation. Without immediate action by Congress, the withholding will begin impacting contractors soon, as businesses must begin tailoring their bookkeeping systems in anticipation of the provision taking effect at the beginning of 2012.

Completed Contract Method Reform

NRCA supports bipartisan legislation (H.R. 6097) introduced in the 111th Congress to modify the tax code to expand the number of construction contractors who may utilize the completed contract method of accounting when dealing with long-term construction contracts.

Under current law, construction contractors cannot use the completed contract method if average annual gross receipts exceed $10 million, a threshold that has not been adjusted for inflation since 1986. Contractors who cannot utilize the completed contract method must use the percentage of completion method of accounting, which often does not accurately reflect results due to the required use of cost estimates. The percentage of completion method is a major paperwork/compliance burden for small and mid-sized contractors because they have to estimate the percentage of a completed project and then retroactively amend those filings in subsequent years based on the actual numbers. Like the three percent withholding tax, this system represents an impediment to business growth and job creation, as increasingly more time and resources must be devoted to tax compliance.

H.R. 6097 would increase the threshold for using the completed contract method, index it for inflation, and also provide relief from the Alternative Minimum Tax and “look-back” provisions in the tax code. This legislation would significantly reduce the complexity of the tax code for many construction employers. NRCA looks forward to working with Congress on this issue of importance to the construction industry going forward.

Conclusion

Again, NRCA urges Congress to address the alarming 20 percent unemployment rate in the construction industry by moving forward with these and other initiatives to reduce tax complexity, which will help boost economic growth and create jobs. NRCA looks forward to working with the members of the committee in this regard. Thank you for your consideration of NRCA’s views on these matters.