Statement of the
American Council of Engineering Companies
On the Ways and Means Committee Small Business and
Passthrough Entity Tax Reform Discussion Draft

May 29, 2013

The American Council of Engineering Companies (ACEC) – the business association of the nation's engineering industry – is pleased to submit comments to the House Ways and Means Committee on the Committee's small business and passthrough entity tax reform discussion draft.

ACEC members – numbering more than 5,000 firms representing hundreds of thousands of engineers and other specialists throughout the country – are engaged in a wide range of engineering works that propel the nation's economy, and enhance and safeguard America's quality of life. The Council represents engineering businesses of all sizes, from the single professional engineer to firms that employ tens of thousands of professionals working in the United States and throughout the world.

A key concern for ACEC members in the discussion draft is the proposal to change the rules regarding the use of the cash method of accounting. Under current law, professional services firms, including engineering firms, can generally use cash accounting for tax purposes. The discussion draft proposes to limit the use of cash accounting to sole proprietorships and firms with less than $10 million in gross receipts.

ACEC supports the increase in the small business threshold to $10 million. However, a significant number of engineering firms with revenues over $10 million currently use the cash method of accounting, either under the QPSC exception, or because they are organized as S corporations or partnerships.

Engineering firms normally carry large balances of accounts receivable and work in progress, representing work performed for clients for which they have not yet been paid. The primary cost for engineering firms is labor, and approximately 85 percent of a typical firm's expenses can be attributed to payroll, benefits, and similar regular expenses. Engineering firms generally have to wait at least 120 days to be paid for services rendered to their clients, and at the same time must pay their employees every two weeks. While this situation can create cash flow challenges for firms, the use of cash accounting helps to mitigate those challenges by allowing firms to make tax payments after receiving payment for their services.

By contrast, forcing firms to switch to accrual accounting would create a number of problems, most notably requiring firms to use debt financing to cover the delta between expenses and receipts, which is much harder for small and mid-size firms to access today. The resulting cash flow challenges that would result from a switch to accrual accounting would create additional negative consequences, including workforce downsizing among some firms, delayed expansion plans, and decreased shareholder distributions. In fact, many S corporations utilize shareholder distributions to facilitate ownership transition, and any reduction could have a detrimental impact on a firm's long-term viability. All of these outcomes would take money out of the productive economy, jeopardize well-paying jobs, and burden firms that continue to struggle in the soft economy.

The simple premise of cash accounting allows engineering firms to pay income taxes on their revenue when they are actually paid, rather than when they submit an invoice. Conversely, they are not allowed to take deductions for expenses when they are incurred, but when the expense is actually paid. Once again, we believe this approach is fair for an industry whose product is intellectual capital, not hard physical inventory.

For these reasons, ACEC strongly recommends that the House Ways and Means Committee continue to allow engineering firms and other similar businesses to use cash accounting as they have done for decades.

ACEC appreciates the committee's focus on passthrough entity issues in its discussion draft. Nearly 80 percent of the Council's member firms are organized as some type of passthrough entity, including S corporations, partnerships, and sole proprietorships. The broad distribution of ACEC members across both the C corporation and passthrough structures drives the Council's support for comprehensive tax reform. Although reforming the corporate and individual sides of the tax code simultaneously will be challenging, it is the only approach that will not disadvantage a large segment of the business community and their employees.

ACEC has endorsed the S Corporation Modernization Act, on which Option 1 of the discussion draft is based. The Council believes that these are reasonable changes that would provide greater flexibility to S corporations. ACEC is continuing to assess the more comprehensive proposals to unify the federal tax rules for S corporations and partnerships that are presented in Option 2.

Finally, ACEC would like to express support for the discussion draft's proposal to make permanent the Section 179 expensing level to provide consistency for investment planning. We encourage you to make the permanent level as high as possible to promote investment and economic growth, but think that it should be at least $250,000, with the deduction phased out for investments exceeding $800,000. Expensing allows engineering firms to invest in the equipment they need in order to succeed.

Once again, on behalf of the nation's engineering industry, we thank the House Ways and Means Committee for the opportunity to submit comments.