November __, 2016

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady:

I am writing on behalf of the American Council of Engineering Companies (ACEC) and our member firms to submit our comments on the tax reform blueprint you released in June. We appreciate the opportunity to engage in this dialogue.

The American Council of Engineering Companies (ACEC) – the business association of the nation's engineering industry – 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. Approximately three-quarters of the Council's member firms are organized as some type of passthrough entity, such as 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 a balanced and comprehensive approach to tax reform.

We appreciate the steps the blueprint takes in this direction by proposing to lower top tax rates for both corporations and passthrough businesses concurrently. Although this will be difficult, such an approach is essential to avoid creating a bias in the tax code for one business structure over another.

However, while the blueprint proposes lowering the top corporate tax rate and the top rate on passthrough active business income by the same percentage, it falls short in achieving true parity. Even when accounting for the double tax on corporate income due to the taxation of dividends, which would be subject to lower rates under the blueprint, and the proposed repeal of the Affordable Care Act taxes on earned and unearned income, we remain concerned that C corporations and passthroughs in the engineering industry would face different top tax rates under the blueprint as it is currently envisioned. Achieving rate parity is a key priority for ACEC and we appreciate the opportunity to work with you on this challenging but important piece of tax reform.

In order to achieve the goal of lowering rates across the board, ACEC understands the necessity of eliminating a number of tax credits and deductions. At the same time, there are tax provisions that meet the blueprint's goals of promoting economic growth and competitiveness. We appreciate the Committee's consideration of the following issues of importance to the engineering industry:

- R&D tax credit: ACEC was strongly supportive of making the R&D tax credit permanent, and supports its retention in the blueprint. Engineering firms can qualify for the credit for certain innovative design solutions. We are concerned, however that the IRS appears to be challenging the claims of some firms to the credit without a reasonable basis for doing so. ACEC encourages Committee oversight of the IRS in this area to ensure that the agency is respecting congressional intent.

- Section 199: We would also like the Committee to be aware of the importance of the Section 199 domestic production activities deduction to the engineering industry, and to consider retaining Section 199. As you know, the deduction was created to mitigate against the impact of a World Trade Organization (WTO) decision that affected firms operating abroad. Design and construction of real property in the U.S. create thousands of jobs and are an important part of economic growth. In addition, engineering firms face international competition both in the U.S. and around the world every day. Section 199 is a key provision that helps U.S. firms to compete in the global marketplace and should be retained.

- Cash accounting: ACEC would like to reiterate our support for preserving the ability of engineering firms to use the cash method of accounting. As you know, there have been proposals in recent years that would have restricted the use of cash accounting to firms with less than $10 million in gross receipts. ACEC strongly opposes these proposals.

  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 require firms to use debt financing to cover the delta between expenses and receipts, which is hard for small and mid-size firms to access. The 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.

  We would also note that the blueprint is based on the idea of moving from an accrued income base for our tax system to a consumption based system. ACEC believes that the use of the cash method of accounting dovetails with this new approach to the tax code.

- Expensing and interest deductibility: The blueprint proposes full expensing for capital purchases and limits on interest deductibility. While ACEC understands why these two proposals are linked, we are concerned that limiting interest deductibility will have negative consequences for engineering firms and other service providers. As you know, expensing is more beneficial in industries that have high capital expenditures. By contrast, professional services, such as engineering, tend to have higher labor expenditures. Engineering firms – particularly small and mid-sized firms – often use debt financing in order to cover the payroll, benefits, and other costs associated with expansion of the firm. Limiting interest deductibility would reduce the ability of firms to deduct these costs of growing the business. In a profession whose primary costs are labor-related, that would translate directly into fewer new jobs and limit the ability of the firm to compete for larger design projects.

- International taxation: Design work overseas is a growing part of the business of many engineering firms, and ACEC supports the proposed change from a worldwide system of taxation to a more territorial system. In general, we believe this will increase the competitiveness of U.S. engineering firms and simplify the tax code. As the blueprint is developed into legislation, we would appreciate additional details on how professional services will be treated in this new system.

- Repeal of AMT and estate tax: ACEC supports the repeal of the corporate and individual AMT, and appreciates their inclusion in the blueprint. The AMT adds significant costs in terms of compliance, and repeal will further the Committee's goal of simplifying the tax code. Repeal of the estate tax is also important, particularly for smaller engineering firms whose owners want the option of maintaining family ownership of the firm.

- Employee ownership: We would like to express our ongoing support for allowing employee ownership of all types of business structures. Many engineering firms are employee-owned, and the Council recommends that Congress maintain tax provisions that support employee ownership and other retirement savings incentives. In particular, many engineering firms promote retirement security and facilitate ownership transition through employee stock ownership plans (ESOPs), and ACEC recommends retaining those provisions of the tax code.

- Infrastructure financing: ACEC believes that the tax code should promote the development of the nation's critical infrastructure, including highways, bridges, transit systems, water, and wastewater. Infrastructure underpins American communities, and is an essential component of a thriving economy. In particular, ACEC urges Congress to address the long-term stabilization of the Highway Trust Fund (HTF) as part of a comprehensive tax reform package. With predictable, sustainable and growing revenue sources – particularly user fees – the Highway

Trust Fund will support infrastructure investments that foster economic growth in a fiscally responsible way.

Thank you again for the opportunity to comment on the blueprint, and we look forward to working with you as the House Ways and Means Committee continues to develop tax reform legislation.

Sincerely,