ACEC
AMERICAN COUNCIL OF ENGINEERING COMPANIES
100 Years of Excellence

July 14, 2017

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PRESIDENT & CEO

The Honorable Orrin G. Hatch
Chairman
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Hatch:

I am writing on behalf of the American Council of Engineering Companies (ACEC) and our member firms in response to your recent request for comments on key areas of tax reform. 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.

We appreciate the opportunity to address the areas you identified that are directly relevant to the engineering industry with the following comments.

Strengthening businesses by lowering tax rates and broadening the tax base

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.

Achieving rate parity among C corporations and passthrough entities is a key priority for ACEC. Discussions of rate parity should include consideration of both the double tax on corporate income, and the Affordable Care Act taxes on the earned and investment income of upper-income individuals, who may be passthrough business owners.

ACEC understands that business tax reform may follow the approach of the House Republican tax reform blueprint and the President's tax reform plan in establishing a separate rate for passthrough business income, instead of lowering the top corporate and individual rates to the same level. We appreciate these efforts to work toward rate parity for all businesses.

We also understand that if there is a significant difference between the passthrough business income tax rate and the top individual tax rate, there will need to be rules in place that discourage passthrough owners from characterizing wage income as business income in order to take

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advantage of the lower rate. We encourage lawmakers to avoid using a fixed ratio of wage and business income for enforcement purposes. Although this could provide clarity for the IRS, it would not reflect the diversity of passthrough businesses, their capital investments, or their labor expenditures. ACEC member firms pay wages that are dictated by the market, and are also influenced by the reasonable compensation standards in the Federal Acquisition Regulation. ACEC would like to work with you in order to craft a solution that focuses on those businesses that do not pay reasonable compensation and does not burden engineering firms and others that play by the rules.

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 promote economic growth and competitiveness. We appreciate the Committee's consideration of the following issues of importance to the engineering industry:

- Section 199: We would 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 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.

- R&D tax credit: ACEC was strongly supportive of making the R&D tax credit permanent and supports its retention. 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 179D: As Congress considers phasing down or restructuring tax credits that support renewable energy, ACEC encourages taxwriters to maintain the Section 179D energy-efficient commercial buildings tax deduction or a similar provision that encourages energy efficiency. Section 179D helps align incentives for building owners to invest upfront in more costly energy-efficient systems that provide a benefit in the form of lower energy usage over a period of years. At the same time, ACEC urges Congress to address the problem of governmental building owners requiring designers to make a cash payment to the governmental entity in exchange for allocating the deduction, as this practice raises a number of serious legal and ethical questions and contradicts congressional intent.

- Expensing and interest deductibility: There are tax reform proposals that would provide full expensing of capital purchases in order to spur economic growth. At the same time, interest deductibility would be limited in order to prevent a negative tax situation. ACEC is 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. Larger engineering firms often use debt financing in order to expand. In a profession whose primary costs are labor-related, limiting interest deductibility would translate directly into fewer new jobs and affect the ability of the firm to compete for larger design projects.

Removing disincentives for savings and investment

We would like to express ACEC's 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.

Updating our international tax system

Design work for overseas projects is a growing part of the business of many engineering firms, and ACEC supports moving from a worldwide system of taxation to a territorial system for all business structures. In general, we believe this will increase the competitiveness of U.S. engineering firms and simplify the tax code. We understand that, as part of shifting to a territorial system, tax-writers will look at measures to ensure that U.S. economic activity is not inappropriately characterized as occurring overseas and avoiding U.S. taxation. At the same time, we encourage the Committee to assess the potential burdens of any compliance provisions on engineering firms that compete internationally.

Finally, 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. A majority of both parties in the House of Representatives – 119 Republicans and 134 Democrats – recently signed onto a letter expressing support for a long-term solution to the HTF structural revenue deficit with a dedicated, user-based revenue stream to support necessary transportation infrastructure investments.

Thank you again for the opportunity to comment on ACEC's tax reform priorities. We look forward to engaging in this dialogue with you.

Sincerely,