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VIA ELECTRONIC SUBMISSION
(www.regulations.gov)

CC:PA:LPD:PR (REG-107892-18)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D.C. 20224

Re: Comments to REG-107892-18, Qualified Business Income Deduction, 83 Fed. Reg. 40884 (Aug. 16, 2018)

To Whom It May Concern:

Pursuant to REG-107892-18, Qualified Business Income Deduction, 83 Fed. Reg. 40884 (Aug. 16, 2018) (the "Proposed Section 199A Regulations"), the American Council of Engineering Companies ("ACEC") respectfully submits the following comments with respect to the application of the deduction provided by Section 199A of the Internal Revenue Code¹ to the engineering industry.

ACEC is the business association of the nation's engineering industry, representing over 5,000 firms engaged in a wide range of engineering works that propel the nation's economy, and enhance and safeguard America's quality of life. ACEC 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.

ACEC appreciates the time and resources that the Treasury Department and the Internal Revenue Service ("IRS") have dedicated in developing the Proposed Section 199A Regulations, including the time and resources devoted to soliciting and incorporating feedback from interested stakeholders, including ACEC. ACEC further appreciates the opportunity to provide these written comments to this important guidance.

As discussed in greater detail below, ACEC supports the Proposed Section 199A Regulations as they practically implement Congress's intent to allow an engineering trade or business (hereinafter, "engineering") to benefit from the Section 199A deduction. ACEC, however,

¹ All Section references are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder, unless otherwise specified.

believes that an appropriate technical correction should be considered by the Congress to fully effectuate this intent.

I. Statutory and Regulatory Framework

A. General

Subject to certain qualifications and limitations, Section 199A, as enacted by Public Law 115-97 (Dec. 22, 2017) (commonly referred to as the “Tax Cuts and Jobs Act” or “TCJA”),² provides a deduction of up to 20 percent of qualified income from a domestic trade or business (“qualified business income”) operated as a sole proprietorship or through a partnership, S corporation, trust or estate.³ For purposes of the deduction, qualified business income must be with respect to a “qualified trade or business,” which is defined as any trade or business other than (i) a specified service trade or business (“SSTB”), or (ii) the trade or business of performing services as an employee.⁴

B. “Specified Service Trade or Business” As Defined in the Senate-Passed Bill

An SSTB was originally defined in the version of the TCJA that passed the Senate⁵ as follows:

The term “specified service trade or business” means any trade or business involving the performance of services described in section 1202(e)(3)(A), including investing and investment management, trading, or dealing in securities . . . , partnership interests, or commodities⁶

Importantly, (i) the Senate bill incorporated Section 1202(e)(3)(A) without modification in defining an SSTB, and (ii) Section 1202(e)(3)(A) explicitly references “engineering.”⁷ As a

² Section 199A was subsequently amended by the Consolidated Appropriations Act, 2018, P.L. 115-141 (Mar. 23, 2018).

³ I.R.C. § 199A(a).

⁴ I.R.C. §§ 199A(c)(1), 199A(d)(1). For purposes of this analysis, it is assumed that the taxable income threshold and de minimis exceptions from the application of the SSTB limitation do not apply. I.R.C. § 199A(d)(3); Prop. Treas. Reg. § 1.199A-5(c)(1).

⁵ The version of the TCJA that the House of Representatives initially passed did not include the Section 199A deduction, but rather featured a reduced tax rate on certain qualified business. H.R. 1, § 1004, as passed by the House of Representatives on November 16, 2017. The Conference Committee did not adopt this provision, instead following the Senate version of H.R. 1, with modifications, as discussed below. *See* H. Rep. No. 115-446, at 22 (Dec. 15, 2017) (Conf. Rep.) (“The Conference Report follows the Senate amendment with modifications.”).

⁶ *See* H.R. 1, § 11011, as passed by the Senate on December 2, 2017.

⁷ Section 1202(e)(3)(A) defines the term “qualified trade or business” for purposes of that section as “any trade or business involving the performance of services in the fields of health, law, **engineering**, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees” (emphasis added).

result, under the Senate-passed bill, engineering would have been considered an SSTB ineligible for the Section 199A deduction.⁸

C. “Specified Service Trade or Business” As Defined in the Enacted Bill

As a result of the conference agreement to the TCJA, Section 199A(d)(2), as enacted by Section 11011 of TCJA, contained an important amendment to the definition of an SSTB:

any trade or business—

(A) which is described in section 1202(e)(3)(A) (**applied without regard to the words “engineering, architecture,”**) or which would be so described if the term “employees or owners” were substituted for “employees” therein, or

(B) which involves the performance of services that consist of investing and investment management, trading, or dealing in securities . . . , partnership interests, or commodities⁹

As stated in the Conference Report to the TCJA (the “TCJA Conference Report”), the purpose of this modification was to exclude engineering from the definition of an SSTB:

The conference agreement modifies the definition of a specified service trade or business in several respects. **The definition [of an SSTB] is modified to exclude engineering and architecture services**, and to take in to account the reputation or skill of owners.¹⁰

Thus, as a result of the conference agreement modifying the definition of Section 1202(e)(3)(A) to exclude engineering for purposes of defining an SSTB under Section 199A, engineering is excluded from the definition of an SSTB such that it qualifies for the Section 199A deduction.

II. The Proposed Section 199A Regulations Practically Implement Congressional Intent to Allow Engineering to Qualify for the Section 199A Deduction

The Proposed Section 199A Regulations practically implement Congressional intent as discussed in the TCJA Conference Report to allow income derived from an engineering business to qualify for the Section 199A deduction.

A. Application of the SSTB Definition to Engineering

Pursuant to Section 199A(d)(2), Prop. Treas. Reg. § 1.199A-5(b) defines an SSTB as any trade or business involving the performance of services (i) in one or more of the fields of health, law

⁸ See “Reconciliation Recommendations Pursuant to H. Con. Res. 71,” S. Rpt. 115-20, at 378 (Dec. 1, 2017) (S. Fin. Comm. Rep.).

⁹ I.R.C. § 199A(d)(2) (emphasis added)

¹⁰ See H. Rep. No. 115-446, at 22 (Dec. 15, 2017) (Conf. Rep.) (emphasis added).

accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing and investment management, trading or dealing in securities, partnership interests or commodities (collectively, “Enumerated SSTBs”) and (ii) any trade or business in where the principal asset of such trade or business is the reputation or skill of one or more of its employee or owners (“Reputation or Skill SSTBs”).¹¹ Prop. Treas. Reg. § 1.199A-5(b)(2)(xiv) defines a Reputation or Skill SSTB as limited to any trade or business that receives (i) income from endorsements; (ii) income derived from the use of an individual’s image, likeness, name, signature, voice, trademark or other symbol associated with the individual’s identity; or (iii) income for making a personal appearance.¹²

Based on the application of this definition of an SSTB, it is clear that engineering is not an SSTB.¹³ As an initial matter, based on the explicit exclusion of “engineering” from the definition found in Section 199A(d)(2)(A), engineering is not an Enumerated SSTB. Similarly, under Prop. Treas. Reg. § 1.199A-5(b)(2)(xiv), engineering could not be a Reputation or Skill SSTB as engineering consists of income from the performance of professional services, rather than income from endorsement, licensing or appearance activities.¹⁴

B. An Example in the Proposed Section 199A Regulations Confirms That Engineering is Not an SSTB

The conclusion that engineering is not an SSTB (either as an Enumerated SSTB or a Reputation or Skill SSTB) is confirmed by an example contained in Prop. Treas. Reg. § 1.199A-5(d). As noted above, for purposes of the Section 199A deduction, qualified business income must be derived from a “qualified trade or business,” which is defined as any trade or business other than (i) an SSTB, or (ii) the trade or business of performing services as an employee.¹⁵ In this regard, pursuant to Section 199A(d)(1)(B), Prop. Treas. Reg. § 1.199A-5(d)(3) provides detailed rules and examples in defining the trade or business of performing services as an employee, including rules and examples regarding the treatment of former employees to address potentially abusive

¹¹ See also 83 Fed. Reg. at 40896; TCJA Conference Report, at 223.

¹² See 83 Fed. Reg. at 40899 (“In sum, the Treasury Department and the IRS believe that the ‘reputation or skill’ clause as used in section 199A was intended to describe a narrow set of trades or businesses, not otherwise covered by the enumerated specified services, in which income is received based directly on the skill and/or reputation of employees or owners.”)

¹³ See Davison, Architects, Engineers Will Get Pass-Through Tax Break: Official,” Bloomberg BNA Daily Report for Executives (Feb. 5, 2018) (“engineers will qualify for a 20 percent deduction on their business income after confusion about whether those businesses count for the new tax break afforded to pass-throughs, a Treasury official said”).

¹⁴ It should be noted that engineering trade or businesses, similar to other professional service trade or businesses, frequently incorporate the name of their owners into the names of their businesses (for example, Jones Engineering Company or Smith Engineering Company). The naming of businesses in such a manner, absent the presence of related endorsement, licensing or appearance income, does not result in a trade or business qualifying as a Reputation or Skill SSTB under Prop. Treas. Reg. § 1.199A-5(b)(2)(xiv).

¹⁵ I.R.C. § 199A(d)(1). See also Prop. Treas. Reg. § 1.199A-5(a)(3).

situations in which a business arrangement is changed with respect to a former employee in order secure treatment as a “qualified trade or business.”¹⁶

Example 3 to Prop. Treas. Reg. § 1.199A-5(d)(3)(ii) addresses a fact pattern in which a longstanding individual engineer employee of an engineering firm is admitted as a partner in the firm. The example is used to demonstrate the need to determine if the individual engineer is treated as (i) still in the trade or business of performing services as an employee for the engineering firm (and, therefore, not in a “qualified trade or business” and not eligible for the Section 199A deduction), or (ii) a bona fide partner in the engineering firm who shares in the overall net profits and losses of the enterprise (and, therefore, participates in a “qualified trade or business” eligible for the Section 199A deduction).

Underlying the example is the important and correct assumption that engineering is a qualified trade or business and not an SSTB. The example would be rendered meaningless if engineering were an SSTB because it would result in a loss of the Section 199A deduction under either scenario posited in the example (*i.e.*, the employee being treated in the trade or business of performing services as an employee or the employee being treated as a bona fide partner in an SSTB). Thus, this underlying assumption in Example 3 confirms the analysis contained above that engineering is not an SSTB.

III. An Appropriate Technical Correction Should Be Considered by the Congress to Fully Effectuate Congressional Intent

As noted above, ACEC supports the Proposed Section 199A Regulations as they practically implement Congressional intent in allowing engineering to qualify for the Section 199A deduction. As noted above, that conclusion is based on an application of the Proposed Section 199A Regulations to determine that engineering is not an Enumerated SSTB or a Reputation or Skill SSTB. This conclusion is based on (i) the *per se* exclusion of engineering from the list of Enumerated SSTBs based on the statutory language of Section 199A(d)(2)(A), and (ii) a determination that as a practical matter engineering is not a Reputation or Skill SSTB given the income flows associated with engineering. It is important to note, however, that the underlying legislative history to Section 199A provides that engineering qualifies on a *per se* basis for the Section 199A deduction and that it is excluded not only from the list of Enumerated SSTBs but also from the application of the Reputation or Skill SSTB test.

Specifically, as discussed in greater detail above, the conference agreement to TCJA modified the definition of an SSTB. As noted in the TCJA Conference Report, “[t]he definition [of an SSTB] is modified to exclude engineering and architecture services”¹⁷ This language clearly evidences Congressional intent to provide for a *per se* exclusion of engineering from the definition of an SSTB such that income derived from engineering *per se* qualifies for the Section 199A deduction.

¹⁶ See 83 Fed. Reg. at 40901 (“Section 199A provides that the trade or business of providing services as an employee is not eligible for the section 199A deduction. Therefore, taxpayers and practitioners noted that it may be beneficial for employees to treat themselves as independent contractors or as having an equity interest in a partnership or S corporation in order to benefit from the deduction under section 199A.”).

¹⁷ TCJA Conference Report, at 223.

In implementing this Congressional intent, Treasury and the IRS proposed guidance with respect to Enumerated SSTBs that specifically incorporates the statutory exclusion for engineering. However, Treasury and the IRS did not incorporate a similar exclusion into the guidance with respect to Reputation or Skill SSTBs, resulting in the requirement that the Reputation or Skill SSTB test be applied to engineering. As discussed in greater detail above, the application of the Reputation or Skill SSTB test of the Prop. Treas. Reg. § 1.199A-5(b)(2)(xiv) will result in engineering not being treated as a Reputation or Skill SSTB. However, the application of the test itself is inconsistent with Congressional intent to exclude engineering from both the Enumerated SSTB and Reputation or Skill SSTB tests and provide a *per se* exclusion from the definition of an SSTB, such that qualifying business income derived from engineering *per se* qualifies for the Section 199A deduction. Stated differently, subjecting engineering to the Reputation or Skill SSTB test is clearly contrary to Congressional intent “to exclude engineering . . . services” from the definition of an SSTB such that engineering *per se* qualifies for the Section 199A deduction.¹⁸

Therefore, consistent with Congressional intent, an appropriate technical correction should be considered to provide the *per se* exclusion of engineering from the definition of an SSTB that Congress intended. Such technical correction could be implemented through a specific statutory exclusion for engineering from the Reputation or Skill SSTB test.¹⁹ Although as a practical matter the enactment of such a technical correction may not have any impact given that engineering will not be treated as a Reputation or Skill SSTB if the Treasury and IRS adopted final regulations similar to the Proposed Section 199A Regulations, it nonetheless is important to ensure that the statutory language of the provision is consistent with the underlying legislative intent. This would be especially true if there are adverse changes to the Proposed Section 199A Regulations upon their finalization or an adverse application and enforcement of such regulations by the IRS.

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¹⁸ Despite the clear Congressional intent, the lack of an engineering-specific exclusion from the statutory Reputation or Skill SSTB definition has created uncertainty as to its application. *See, e.g.*, Davison, “Confused About The New Pass-Through Deduction? So Is Your Lawyer,” Bloomberg DNA Daily Tax Report (Jan. 2, 2018); New York State Bar Association Tax Section, Report on Section 199A, at 5, 12 (Mar. 23, 2018).

¹⁹ Specifically, Section 199(d)(2)(A) should be modified to provide the following bolded language as follows “which is described in Section 1202(e)(3)(A) (applied without regard to the words “engineering, architecture,”) or which would be so described if the words “employees or owners ***other than engineering or architecture***” were substituted for “employees” therein.”

Thank you for the opportunity to submit these comments on the Proposed Regulations. ACEC would welcome the opportunity to meet with Treasury and the IRS to discuss them in greater detail or to answer any question that you may have.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Linda Bauer Darr". The signature is written in a cursive, flowing style.

Linda Bauer Darr
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