



AMERICAN COUNCIL OF ENGINEERING COMPANIES

## S Corporation Reform

### ISSUE

Engineering firms organized as S corporations make up a significant percentage of the industry. ACEC supports the S Corporation Modernization Act of 2017, which would update the rules governing S corporations. ACEC also opposes increasing payroll taxes on engineering firms that are already in compliance with the law.

### OVERVIEW

Subchapter S of the Internal Revenue Code (S corporations) was enacted in 1958 to provide entrepreneurs the advantage of corporate protection from liability, along with the single level of taxation enjoyed by partnerships and limited liability companies. However, the S corporation statute contains a variety of limitations and restrictions. Even though some very important improvements have been made over the years, more needs to be done to bring the tax treatment of these important businesses into the twenty-first century.

ACEC strongly supported provisions included in the American Jobs Creation Act of 2004 (P.L. 108-357) to simplify the tax treatment of S corporations and to make it easier for businesses to qualify as S corporations. The law increases the number of eligible shareholders from 75 to 100, treats all family members within six generations as one shareholder, and allows distributions from an employee stock ownership plan (ESOP) held by an S corporation for the purposes of repaying a loan used to purchase employer securities without losing ESOP qualification or violating rules against prohibited transactions.

Additional reforms can be enacted that will simplify the tax treatment of S corporations and make it easier for businesses to qualify as S corporations. The S Corporation Modernization Act of 2017 (H.R. 1696/S. 711), sponsored by Representatives Dave Reichert (R-WA) and Ron Kind (D-WI), and Senators John Thune (R-SD) and Ben Cardin (D-MD), would modify rules on S corporation ownership, as well as those on passive investment.

Congress has also considered proposals to increase payroll taxes on S corporation partners in services firms, including engineering firms. Although intended to act as a tax enforcement mechanism, these provisions would affect tax-compliant engineering firms. ACEC strongly opposes these measures and has worked to defeat them.