



October 10, 2024

Rep. Lloyd Smucker
Chair, Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Rep. Greg Steube
Vice Chair, Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Rep. Vern Buchanan
Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
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Rep. Adrian Smith
Main Street Tax Team
Committee on Ways and Means
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Rep. Jodey Arrington
Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Rep. Beth Van Duyne
Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chair Smucker and Members of the Main Street Tax Team:

On behalf of the American Council of Engineering Companies (ACEC) – the business association of the nation’s engineering industry – I appreciate the opportunity to submit comments on our priorities in the 2025 tax policy debate.

Founded in 1906, ACEC is a national federation of 51 state and regional organizations representing more than 5,500 engineering firms and 600,000+ engineers, surveyors, architects, and other specialists nationwide. ACEC member firms drive the design of America’s infrastructure and built environment.

The ACEC Research Institute, in its 2023 Economic Assessment of the Engineering + Design Services Industry, found that the industry has a significant impact on the U.S. economy:

- Total architecture/engineering (A/E) industry contribution to GDP of \$627 billion
- 5 million total A/E supported jobs
- Average wages of \$104,800
- Total tax collections (federal, state, and local) of \$128 billion

As Congress prepares for a wide-ranging debate over tax policy in 2025, ACEC urges Congress to:

- Continue the balanced tax treatment of all business structures, including C corporations, S corporations, partnerships, LLCs, and sole proprietorships.

- Restore full deductibility of R&D expenses to support innovation.
- Reinforce employee ownership, through employee stock ownership plans (ESOPs) and groups of employee-owners.
- Extend and expand the Section 127 educational tax benefit to recruit and retain workforce.
- Promote energy efficiency by improving the Section 179D energy-efficient commercial buildings tax deduction.

Balanced tax treatment of all business structures

ACEC member firms range in size from a single professional engineer to businesses that employ thousands of professionals. Approximately one-third of ACEC member firms are organized as C corporations and two-thirds are organized as passthrough entities, including S corporations, LLCs, partnerships, and sole proprietorships.

For this reason, ACEC has consistently advocated for balanced tax treatment of C corporations and passthrough entities. ACEC supported the 2017 Tax Cuts and Jobs Act (TCJA) because it created the Section 199A passthrough deduction at the same time as it lowered the corporate rate from 35 percent to 21 percent. Without Section 199A, the disparity in the tax treatment of C corporations and passthroughs would have resulted in a competitive disadvantage and forced many small businesses to bear the administrative costs of changing their tax structure. Among ACEC member firms, 75 percent have 50 or fewer employees.

Engineering and architecture were originally part of the specified services trade or business (SSTB) category for Section 199A, which does not have full access to the deduction. Eligibility for Section 199A begins to phase out for SSTB business owners if their income exceeds \$383,900 (married filing jointly)/\$191,950 (individual) and is completely eliminated if their income exceeds \$483,900 (married filing jointly)/\$241,950 (individual).

ACEC made the case to Congress that engineering and architecture were different from the others in the SSTB category for one key reason: our member firms qualified for the former Section 199 domestic production activities deduction that was repealed in TCJA. When Section 199 was enacted as part of the American Jobs Creation Act of 2004, Congress explicitly provided that engineering and architecture qualified for the deduction as it applied to the construction of real property.

Moving to the debate in 2017, had Congress denied engineering and architecture firms full access to Section 199A, they would have experienced a tax increase. The other "specified services" industries such as law and accounting did not feel this impact because they didn't qualify for the former Section 199. This key distinction resonated with then-Ways and Means Committee Chairman Kevin Brady and members of the Committee, who ultimately agreed that it would be unfair to impose a net tax increase on engineering and architecture, which led to the decision to remove these industries from the SSTB category.

Although the 21 percent corporate tax rate is permanent, the Section 199A deduction expires at the end of 2025. ACEC urges Congress to maintain balanced tax treatment of the engineering industry by making Section 199A permanent and continuing to make engineering and architecture fully eligible for the deduction.

Innovation

Innovation is at the heart of what ACEC members do every day in delivering engineering and design services to our public and private sector clients. Through innovation the engineering industry facilitates economic growth and puts the nation on stronger footing to compete in the global marketplace.

As part of the Tax Cuts and Jobs Act of 2017, Congress changed how taxpayers deduct R&D expenses. Starting on January 1, 2022, firms could no longer deduct R&D expenses in the year they were incurred – as they had been able to since 1954 – and now must amortize those expenses over five years in most cases.

The tax impact of R&D amortization is substantial. Amortization of R&D expenses is causing significant cash flow problems for engineering firms and forcing them to put hiring on hold, delay investments in technology, and reconsider plans to grow. Firms need to offer increasingly higher salaries in order to compete for scarce engineering talent and have been hindered from doing so by the huge tax bills created by the R&D amortization requirement. Businesses that are growing will never fully catch up in terms of cash flow as their tax bills also grow.

These impacts are widespread across the industry but are particularly burdensome for small and midsize businesses. Many engineering firms have had to use the firm's line of credit at high interest rates to pay the tax. An ACEC member firm headquartered in Missouri with \$11 million in revenues had to pay \$1 million in 2022 federal and state taxes and first quarter 2023 estimated taxes. This firm had to use its line of credit for additional estimated taxes in 2023 and beyond. In some cases, that has not been enough and firm owners have taken second mortgages on their homes to keep the firm running and paying its bills.

As we discuss in the next section, employee ownership is the standard in the engineering industry. Most firms have buy-sell agreements that require retiring employee-owners to sell their shares back to the firm. This means that those owners may never recoup the taxes they paid, and it creates a disincentive for new owners to invest in the firm.

ACEC strongly supports repeal of the R&D amortization requirement and a return to full deductibility of R&D expenses.

Employee ownership

Employee ownership has long been the norm in the engineering industry. ACEC members include small firms with one employee-owner, larger firms with a team of employee-owners, and many firms that are 100 percent employee-owned through an employee stock ownership plan (ESOP). Engineering firms are typically owned by people who actively work at the business. Congress has consistently demonstrated bipartisan support for employee ownership and the retirement security that it provides and ACEC asks Congress to continue this support.

ACEC would also urge Congress to address a challenge for certain S corporations with a team of employee-owners. Under current law an S corporation can only have 100 shareholders. Congress modified the law in 2004 to treat six generations of a family as one S corporation shareholder to

facilitate keeping family-owned businesses in the family. In addition, an ESOP counts as a single shareholder of an S corporation. However, each employee owner of an S corporation that does not use an ESOP structure counts as a separate shareholder. The 100-shareholder limit is an impediment to broad-based employee ownership without an ESOP.

A straightforward change would remove this impediment: allowing firms to count all employee-owners as one shareholder. This change would align the treatment of employee-owned firms with that of family-owned firms and ESOP-owned firms. ACEC urges Congress to make this reasonable change.

Workforce

America's engineering industry needs more engineers in the talent pipeline to support a growing economy. According to the Bureau of Labor Statistics the engineering workforce is currently at full employment. In addition, analysis from the ACEC Research Institute (ACEC RI) finds that we will need more than 82,000 engineers and other professionals to deliver the projects funded under the Infrastructure Investment and Jobs Act. Surveys of ACEC members show that over half of engineering firms are turning down work specifically due to workforce shortages.

ACEC supports a comprehensive approach to this challenge, including tax policies that expand the ability of employers to provide educational assistance to their employees. ACEC member firms assist employees with educational expenses and student loan repayment using the Section 127 benefit. This is both a workforce retention and workforce development tool, as engineers often pursue graduate studies once they are employed.

Congress should extend the Employer Participation in Repayment Act, which allows employers to provide student loan repayment assistance without it being a taxable benefit for employees. In addition, the maximum amount of \$5,250 allowed under Section 127 for student loan repayment and educational expenses should be indexed for inflation.

Energy policy

ACEC members are playing a critical role in designing cutting-edge projects that improve the energy-efficiency and resilience of the nation's built environment, including buildings that are eligible for the Section 179D energy-efficient commercial buildings tax deduction.

In the case of the Section 179D deduction, if the building owner is a governmental or non-profit entity that cannot claim a tax deduction, it can allocate the deduction to the primary designer of the energy-efficient lighting, HVAC, and building envelope. We are concerned that some governmental and non-profit entities and their intermediaries continue to solicit payments in exchange for allocation of the deduction, which runs contrary to the intent of this tax incentive. In these situations, the designer is told that they must make a payment to the governmental or non-profit entity and pay a fee to the intermediary before they will sign the allocation paperwork. Neither the statutory text nor regulatory guidance contemplates providing a payment in exchange for allocation of the Section 179D deduction.

In addition to undercutting the purpose of Section 179D in promoting energy efficiency, the harmful effects of this practice fall heaviest on small engineering and architectural firms. In

many cases, small firms do not have the wherewithal to meet demands for these payments. The result is that these businesses lose the opportunity to work on important projects that support the employment of highly skilled workers, with reverberating effects throughout local economies.

ACEC member firms are also very concerned about the ethical implications of making such payments in exchange for the deduction. Professional engineers are required to meet strict ethical standards to maintain their license and any indication that an engineering firm made a cash payment to obtain the allocation letter could be brought before the state licensing board.

Finally, ACEC encourages Congress to revisit the IRS Office of Chief Counsel memorandum AM 2010-007 stating that the Section 179D deduction reduces the owner's tax basis in the ownership interest. This position makes it difficult for engineering firms that are organized as passthrough entities to benefit from the allocation of the deduction in the same way as engineering firms organized as C corporations.

Design firms structured as passthrough entities are required to take the allocated 179D deduction at the entity level, which reduces the individual owner's basis. This results in additional tax when the benefit of this deduction is distributed to the owner. This tax consequence for passthrough entities places C corporations in a more favorable position as there is no similar reduction of the tax benefit they are able to claim. This disparity could be remedied by providing for basis to be retained for the passthrough owner in the case of a 179D allocation, or by directing the deduction to be taken at the owner level rather than the entity level. The former Section 199 is an example of how passthrough entities can fairly benefit from a deduction being computed at the owner level rather than the entity level.

On behalf of the nation's engineering industry, thank you for your consideration of our tax priorities and please let us know if we can assist further.

Sincerely,

A handwritten signature in black ink, appearing to read "Linda Bauer Darr". The signature is fluid and cursive, with the first name "Linda" being the most prominent.

Linda Bauer Darr
President & CEO