



AMERICAN COUNCIL OF ENGINEERING COMPANIES

Tax Reform for the Engineering Industry

OVERVIEW

Passed at the end of 2017, the Tax Cuts and Jobs Act (HR 1) represents the first major overhaul the federal tax code in over 30 years. ACEC's primary objective through the consideration of HR 1 was to achieve balanced tax reforms that would help both C corporations and passthrough firms (S corporations, partnerships and LLCs) to be more competitive in the marketplace at home and abroad. Other objectives included protecting the ability of engineering firms to use cash accounting, as well as protecting existing retirement and employee ownership mechanisms, such as ESOPs.

The law lowers the corporate tax rate from 35 to 21 percent, and creates a new 20 percent tax deduction for passthrough firms. The most significant challenge ACEC faced at the start of the tax reform process was the exclusion of engineering passthrough firms (together with other service-related industries, such as doctors and lawyers) from the proposed tax benefits in the House and Senate versions of HR 1.

In response to a major lobbying effort by ACEC – which included nearly 6,000 contacts by Council members to lawmakers – the final version of the legislation allows engineering firms to fully utilize the new 20 percent deduction in the same manner as other non-service passthrough industries.

ACEC will continue to engage with Congress, the Department of Treasury, and the Internal Revenue Service as regulatory guidance is developed to implement HR 1.

KEY ELEMENTS IN HR 1

- Corporate tax rate drops from 35 to 21 percent (including personal services corporations).
- New 20 percent passthrough tax deduction on domestic qualified business income:
 - Passthrough owners with incomes below \$315,000 (married filing jointly)/\$157,500 (individual) can claim the 20 percent deduction without limitations. Those income thresholds phase out over \$100,000 (married filing jointly)/\$50,000 (individual), and are indexed for inflation.
 - Passthrough owners with incomes over those thresholds can claim the deduction subject to a limitation of 50% of W-2 wages, or 25% of W-2 wages plus a measure of capital investment (similar to how the Section 199 (9%) deduction is applied).
- Corporate alternative minimum tax (AMT) was repealed.
- Individual AMT is retained with increases in the exemption amount and phaseout threshold.
- The cash method of accounting was preserved; no changes to ESOPs.
- Individual deductibility of state and local taxes is limited to the first \$10,000 of property, income, or sales taxes.
- C corporations and passthrough firms can continue to deduct business state and local taxes if they are levied at the entity level (only eight states tax passthrough income at the entity level).
- Section 199 domestic production activities deduction was eliminated.

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