



Engineering and Architecture Firms Should Qualify for the Proposed Pass-Through Tax Benefit: Key Points

- Both the House-passed and Senate-passed tax reform bills effectively prohibit engineering and architecture firms from taking advantage of the proposed pass-through tax benefits (i.e., the 25% pass-through rate under the House bill and the 23% deduction under the Senate bill) by treating them as ineligible "specified services." Such prohibition is inconsistent with the historical treatment of these firms, and together with other changes being proposed would result in an increased tax burden on engineering firms that is unique to the pass-through business sector.
- Congress explicitly provided that engineering and architecture firms qualified for the Section 199 domestic manufacturing deduction. Section 199(c)(4)(A)(iii). Although Section 199 is understandably subject to repeal under both bills, the impact to engineering and architecture firms is significant in two respects.
 - Engineering and architecture firms are the only industries treated as "specified services" subject to the exclusion from the proposed pass-through tax benefits that also qualified for the Section 199 deduction. In other words, in contrast to other "specified services" industries such as law, accounting and financial services, engineering and architecture are the only industries that (a) lose a significant tax benefit (Section 199) and (b) are excluded from the proposed pass-through tax benefits, resulting in a net tax increase.
 - The explicit inclusion of engineering and architecture firms in the Section 199 deduction evidences recognition of the close connection of these firms to capital investment associated with infrastructure and other capital-intensive projects. To the extent that Congress is determining qualification for the pass-through tax benefits based on capital investment, inclusion of these firms in Section 199 demonstrates the essential role that such firms play in this context.
- Given that engineering and architecture firms are easily distinguished from other firms treated as "specified services" because of the loss of the Section 199 deduction, these firms should be excluded from the definition of "specified services" to ensure they qualify for the proposed pass-through tax benefits and do not incur a net tax increase.
- Senator James Inhofe (R-OK) proposed an amendment (SA 1824) that would provide for such an exclusion. Although the amendment did not receive a vote given the expedited consideration of the Senate bill, it is respectfully requested that it be considered for inclusion in the conference report.
- In summary, the historical treatment of engineering and architecture firms in the Section 199 context in recognition of such firms' integral role in facilitating capital investment justifies the qualification of such firms for the proposed pass-through tax benefits. Further, qualification of these firms is necessary to avoid a net tax increase uniquely imposed on these firms as a result of the loss of the Section 199 deduction.