October 14, 2024

Chairman Jason Smith
House Committee on Ways and Means
1139 Longworth House Office Building
Washington D.C. 20515

Re: AGC Comments to the Main Street, American Workforce, Rural America, and Community Development Tax Teams

Dear Chairman Smith:

The Associated General Contractors (AGC) of America appreciates the ongoing work of the Committee on Ways and Means "Tax Teams" on tax provisions from the 2017 *Tax Cuts and Jobs Act* (TCJA) that are set to expire in 2025, and to identify solutions to ensure that the construction industry, and the economy writ large, is not hit with a massive tax increase in 2026. AGC also thanks them for their outreach to interested parties, including AGC member firms at tax roundtables across the country, to review key provisions from the tax law.

AGC is the leading association in the construction industry representing more than 27,000 firms, including America's leading general contractors and specialty-contracting firms, many of which are small businesses. Many of the nation's service providers and suppliers are also associated with AGC through a nationwide network of chapters. AGC contractors are both union and open shop and are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, levees, locks, dams, water conservation projects, defense facilities, multi-family housing projects, and more.

AGC was a strong supporter of the TCJA. The legislation was the culmination of a multi-year effort towards comprehensive tax reform that lowered tax rates, simplified the tax code, and spurred investment in the broader economy. Prior to 2017, the construction industry faced the highest effective rate of any industry in America—30.3 percent—compared to much lower rates for other industries. This disparity of tax treatment, based on a company's industrial sector and activities, and the associated tax incentives embedded in the tax code to support those activities, created significant distortions in in the economy, and was a major hindrance in the ability of construction companies to modernize, invest in new technology, provide competitive salaries and benefits, and so on. To a significant degree, the TCJA reduced these economic distortions and reduced the economic drag that taxes have on construction.

But while the TCJA was, overall, a significant achievement, there continue to be areas for improvement. The biggest deficiency in the law, and the reason for the creation of these tax teams is of course that, while certain parts of the law were made permanent, many provisions, including many that are extremely important to the construction industry, are temporary. Some of these temporary provisions have already expired, while many others will expire at the end of 2025 or later. These comments will focus on these expiring provisions, as well as offer some additional areas of improvement that the Committee should consider in a comprehensive tax package.

Section 199A Qualified Business Income Deduction

Prior to passage of TCJA in 2017, construction firms organized as "C-Corporations" were taxed at a top rate of 35 percent, while construction firms organized as a pass-through business—such as S Corporations, Partnerships, or Limited Liability Corporations (LLC), which are taxed at the individual rate—had a top rate of 39.6 percent. The TCJA eliminated many deductions, used by all businesses regardless of their structure, to "pay for" a cut in the corporate tax rate to 21 percent, but only cut the top individual rate to 37 percent. To ensure that pass-through businesses, including the majority of construction firms, did not experience a significant tax increase, Congress created the Section 199A Qualified Business Income (QBI) deduction.

The QBI deduction is a 20 percent deduction available to businesses organized as a pass-through, which lowers the top effective marginal tax rate to 29.6 percent. Service businesses whose income primarily comes from labor, such as accounting firms, law firms, and lobbying firms do not qualify for this deduction above a certain income level. An additional guardrail ensures that, in order to qualify for the deduction, at least half of a business's income must be wages paid to employees. Without this deduction, construction firms organized as pass-through businesses would face a persistent disadvantage to competitors organized as C-Corporations. One recent study conducted by Ernst & Young (EY) [1] found that, without the QBI deduction, pass-through businesses would pay, on average, 8 percent higher taxes compared to C-Corporations. For larger businesses, the disparity would increase to 16.5 percent. Ernst & Young also found that the QBI deduction supports roughly 900,000 direct jobs, and nearly 2.5 million indirect jobs.[2] These jobs would be in jeopardy if the QBI deduction expires.

The QBI deduction is also particularly important to construction because of its impact on retained earnings. In commercial construction, a contractor's bonding capacity often dictates how large of a project, and how much work a contractor can work on at any given time. Generally, commercial projects require surety and performance bonds—and for public work, including most federal work, it is legally required—to ensure that a project is completed, contracts are honored, and subcontractors are paid. Sureties thus have an outsized influence on construction firms, and how they deploy capital. Having a "fortress balance sheet" with enough liquidity and reserves in the company's treasury, is essential in the prequalification process. For many pass-through construction firms, the only distributions paid to the owners are for tax payments; everything else is retained in the company.

It is also important to note that, while the QBI deduction will have by far the biggest impact on pass-through construction firms if it is allowed to expire, it is not the only expiring provision that will affect pass-throughs. Other key changes include:

- The individual tax rates revert to pre-2017 levels, including a 39.6% top rate;
- The State and Local Tax (SALT) deduction limitation sunsets; and

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[1] Available at: https://s-corp.org/wp-content/uploads/2023/06/EY-S-Corporation-Association-Pass-through-C-corp-parity-analysis-June-2023.pdf

[2] Available at: https://s-corp.org/wp-content/uploads/2024/09/EY-SCA-Economic-activity-supported-by-Section-199A-deduction-August-2024-FINAL.pdf

- The "Pease" limit on itemized deductions returns.

The study by EY mentioned earlier examined the collective impact of all the expiring provisions on pass-through businesses, which is summarized in this chart:

Effective tax rates	Pre-TCJA (2016)	Post-TCJA (2019)	Post-TCJA (2026)
Large S corporations	41.2%	34.0%	41.2%
Pass-through businesses	32.9%	27.4%	32.9%
C corporations:			
Closely-held, fully taxable shareholders	43.7%	32.0%	31.6%
38% of corporate shareholders nontaxable (CBO)	42.5%	30.5%	30.1%
75% of corporate shareholders nontaxable (TPC)	38.0%	24.8%	24.7%

For the average business organized as a pass-through, its effective tax rate will increase from 27.4 percent to 32.9 percent—**a 20 percent increase**. Importantly, this impact will be felt differently across the income spectrum. According to the Tax Foundation's calculator,[3] a business owner with $50,000 in business income will see their taxes increase by 16 percent, while someone with $100,000 in business income will see their taxes increase by 25.7%.

Preserving the Section 199A QBI deduction, as in H.R. 4721, the *Main Street Tax Certainty Act* introduced by Rep. Lloyd Smucker (R-Pa.), is of paramount importance to the construction industry, and it is essential that it be maintained in 2026 and beyond.

Expensing/100 Percent Bonus Depreciation

AGC strongly supported the provisions of the TCJA to increase cost recovery in the tax code through temporary "100 percent bonus depreciation" and increased small business expensing—to $1 million with a $2.5 million phaseout, permanently indexed to inflation—under Section 179 of the tax code. Additionally, adding eligibility for *used* equipment, in addition to *new* equipment, under the rules for bonus depreciation, were a significant improvement and this has been widely utilized by the construction industry. Unfortunately, the provisions related to bonus depreciation expired in 2023, and will phase down over the next 5 years.

Full expensing is both good for the economy and businesses, but also a significant tax simplification measure. Rather than having to calculate and record depreciation, which for some pieces of equipment can last decades, businesses can instead deduct the full cost of equipment in the year that it was purchased. This also improves cash flow and makes it easier for contractors to replace aging equipment. In the construction industry, this means it is easier for companies to access equipment that is safer, cleaner, and more efficient.

[3] Available at: 2026 Tax Reform Calculator (taxfoundation.org)

It's also important to note that deducting the cost of equipment in the year that it is purchased, rather than depreciating it over time, is not a "tax cut" but is instead a timing shift. Over time, the "cost" of extending this important policy becomes marginal. This important pro-growth policy should be fully restored and made permanent.

Estate Tax/Stepped-Up Basis

AGC supports the full repeal of the estate tax, as in H.R. 7035, the *Death Tax Repeal Act* introduced by Rep. Randy Feenstra (R-Iowa). The estate tax forces many family-owned construction firms to divert scarce resources and capital away from the business and into expensive estate planning and/or insurance. While the TCJA doubled the estate tax exemption from $5 million to $10 million (indexed to inflation) that tax relief will expire in 2025.

The estate tax is overly burdensome on families trying to pass their construction companies to the next generation. While AGC believes the estate tax should be repealed in its entirety, cutting the estate tax exemption in half, as it is scheduled to do in 2026, will be detrimental to the industry. A construction firm's assets, such as construction equipment, offices, and goodwill can grow beyond the exemption level of the estate tax. If the owner of a family-owned firm unexpectedly dies and is assessed with an estate tax bill, the surviving family could be faced with a choice of selling off company assets or going into debt to pay the bill. The higher exemption threshold alleviates this tax burden.
At a minimum, maintaining the current enhanced threshold will ensure continuity of operations and preserve the legacy of these businesses, which are vital to our communities.

"Small Contractor Exemption" from Percentage of Completion Method of Accounting

The Tax Reform Act of 1986 introduced significant revisions to the long-term contract accounting rules, specifically under Section 460 of the Internal Revenue Code. This legislation established new requirements for long-term contracts, which are defined as contracts for manufacturing, building, installation, or construction that extend beyond the tax year in which they were initiated. Unless exempted, contactors are required to use the percentage of completion method (PCM) of accounting on long-term contracts.

For tax purposes, PCM accounting requires that contractors calculate the percentage of a contract that is complete in a given tax year, thereby requiring them to pay taxes on that percentage of income. This system imposes significant administrative burdens and cash flow challenges, particularly for smaller contractors, as PCM is more complicated due to its need for continuous financial tracking and estimating.

Before the changes brought about by the 1986 Act, contractors had the option to utilize the completed-contract method (CCM), which allows them to defer tax payments until the contract is fully completed, or other recognition methods like the cash method to account for long-term contracts. Recognizing the difficulties PCM accounting presented to smaller businesses, Congress established an exemption (commonly called the "small contractor exemption") for contractors with less than $10 million in average annual gross receipts for the previous three years. "Small contractors" can utilize CCM accounting or other simplified accounting methods. Additionally, contracts that are completed in less than one tax year are also exempt from PCM accounting. Unfortunately, the 1986 Tax Reform Act did not index the small contractor exemption to inflation, so for the next 31 years year, more and more contractors were forced to use PCM accounting for tax purposes due to inflation.

While AGC advocated for raising the small contractor exemption to $40 million—which would have accounted for inflation since 1986—AGC strongly supported the provisions in TCJA that raised the small contractor exemption from $10 million to $25 million, and permanently indexed it to inflation.

Unfortunately, while the corporate alternative minimum tax (AMT) was repealed in TCJA, the individual AMT was not. And for pass-through businesses calculating AMT income, long-term contracts must be calculated (or recalculated) using PCM accounting. Because of this AMT provision, small contractors that use accounting methods other than PCM, like CCM or cash method—are required to recalculate their long-term contracts using PCM to determine AMT income. This has the effect of nullifying many of the positive effects of tax simplification for small contractors that was achieved by increasing the small contractor exemption to $25 million. Because of this additional complexity, Congress should remove long-term contracts as an "add back" for the individual AMT.

PCM accounting has an additional pernicious complication for contractors. Under Section 460, during the life of a long-term contract, estimated revenues may differ from actual amounts, necessitating a "look-back" calculation to adjust for any prior income misreporting. If gross profit was overestimated, the IRS owes interest on overpaid taxes; conversely, if it was understated, the taxpayer owes interest on underpaid taxes. This method is applied in the year the contract is completed and in any subsequent year with adjustments to contract price or costs, without changing the total taxes paid over the contract's duration. These "look-back returns" have poor compliance rates, are incredibly complicated, and are poorly understood by the IRS. Doing away with look-back calculations entirely would be a significant simplification measure for the construction industry and would likely have very little impact on tax revenue.

In summary, Congress should:

- Raise the "small contractor exemption" to $40 million and permanently adjust it for inflation;
- Remove long-term contracts as an "add-back" for AMT income calculations; and
- Repeal the requirement that long-term contracts under Section 460 file "look-back" tax returns.

"Excess Loss Limitation" Under Section 461(l)

During consideration of the TCJA, Congress added a provision to limit the ability of pass-through businesses to deduct losses in any given year. If a pass-through business owner incurred losses that exceeded $250,000 (individuals) or $500,000 (joint filers), those losses now have to carry over to the next year (and beyond if the losses are substantial enough) under Section 461(l). While AGC opposed the inclusion of this provision in TCJA, the overall package had other offsetting benefits for the same businesses.

Importantly, this provision was temporarily waived in the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* in 2020 as a recognition that, at least at the outset of the global pandemic, it appeared that construction would be heavily impacted and incur significant losses. Absent this waiver, C-Corporations would have enjoyed the ability to "carryback" their losses, but pass-through businesses would not. This fundamental inequity resulted in what should have been a good precedent for emergency, countercyclical tax relief—i.e. providing both corporate and non-corporate taxpayers the

ability to recoup their losses in the year they are incurred, provide an infusion of cash into struggling businesses, and keeping them afloat during an economic downturn.
Unfortunately, this commonsense policy became politicized during COVID, and became a frequent target to be used as a "pay-for" for other priorities. Under the TCJA, Section 461(l) expired in 2025 along with the other "individual" provisions. But the *American Rescue Plan Act*, and later the *Inflation Reduction Act* extended the expiration date to 2028.

The excess loss limitation is particularly impactful for the construction industry because it is inherently a cyclical business sector. When the economy expands, private and public sector owners tend to make infrastructure investments, while in times of economic downturn, those investments can dry up. Some construction firms were able to stay afloat during the Great Recession between 2008-2012 in part due to their ability to carry-back losses and provide the added tax refunds into funding their operations during the downturn.

Importantly, even under the restrictions of 461(l), losses can still be carried forward, indefinitely. As a result, this policy is mostly a timing shift for when revenue is collected, not a permanent loss in revenue to the Treasury. Congress should reconsider the utility of this provision in the context of other expiring provisions in 2025 and consider whether it should be continued.

Research & Development Amortization/Section 174

An issue that has received a lot of attention since it went into effect in 2022 is the TCJA's requirement that research and development (R&D) costs under Section 174 be amortized over five years, rather than deducted in the year the costs are incurred. Contrary to what some may believe, many construction firms incur significant R&D expenses each year, especially those that invest in Building Information Modeling (BIM), pre-fabrication and off-site manufacturing, or other new technologies such as drones. These investments can improve productivity, reduce costs, and enhance worker safety at the job site.

Amortizing these costs over five years significantly affects a business's cash flow and reduces the incentive for the construction industry to make these investments. Additionally, (as mentioned in the earlier section) because of the requirement that long-term contracts under Section 460 of the tax code use PCM accounting, calculating and reporting these costs for a given construction project is exceedingly difficult and time-consuming. Because of this amortization provision, some long-term contracts using PCM accounting can even result in contractors having to file multiple years of tax returns *after* a project's completion.

AGC supports H.R. 2673, the *American Innovation and R&D Competitiveness Act* introduced by Rep. Ron Estes (R-Kan), and its Senate companion, S. 866, the *American Innovation and Jobs Act* introduced by Senator Hassan, which would reinstate full expensing of R&D costs. Additionally, AGC supports H.R. 7024, the *Tax Relief for American Families and Workers Act* introduced by Chairman Smith which passed the House of Representatives earlier this year, but remains pending in the Senate.

Workforce Provisions

The construction industry's labor shortages remain severe, with most construction firms expecting labor conditions to remain tight despite increasing pay and benefits. According to an AGC survey,[4] 94 percent of firms report having a hard time finding workers to hire. This is the effect of decades of education policies directing students to attend four-year institutions as the only career option, and comparatively little support for career and technical education. While many legislative solutions to the ongoing workforce challenges in construction, such as increasing career and technical education funding through the Perkins Act and expanding Pell grant eligibility for short-term education programs, lie outside the jurisdiction of the Committee on Ways and Means, AGC supports the following proposals to provide new opportunities for workers interested in construction as a career.

- The Work Opportunity Tax Credit (WOTC) is an important tax preference that has proven successful in helping disadvantaged groups find work in the construction industry. The utilization of WOTC has increased in recent years, as Congress has expanded the potential pool of recipients. WOTC helps these targeted groups obtain employment, allowing them to gain the skills and experience necessary for better job opportunities. AGC supports permanently extending WOTC as well as H.R. 6833, the *Improve and Enhance the Work Opportunity Tax Credit Act* which would strengthen and update WOTC by making more workers eligible for the credit.

- The *Freedom to Invest in Tomorrow's Workforce Act* (H.R. 1477/S. 722) would allow students to use funds in a qualified tuition program (529 savings plans) to cover tuition, exams, and training for postsecondary professional workforce certifications. Previously, in the *Setting Every Community Up for Retirement (SECURE) Act,* 529s were expanded to cover the costs associated with registered apprenticeship programs, and H.R. 1477 would continue to build on this success by making training, certification and credentialing programs, in addition to traditional two- or four-year college degree programs, eligible.

<u>Infrastructure Investment - Highway Trust Fund</u>

Federal funding for roads, bridges, and transit systems is derived by revenues from gas tax, diesel tax, and other trucking user fees which are deposited into the Highway Trust Fund (HTF). The HTF provides states and construction companies with long-term certainty to hire and train new employees, plan big projects, and invest in new construction equipment. Over the years the HTF has lost purchasing power due these user fees not being increased or indexed to inflation, improved fuel efficiency, the adoption of hybrid and electric vehicles (EV), higher maintenance costs associated with the increasing weight of the general fleet, and increased costs associated with constructing roads and bridges.

As a result, Congress has had to transfer funding from the General Fund of the U.S. Treasury to the HTF to ensure it can support the funding levels necessary to maintain our nation's infrastructure. The Infrastructure Investment and Jobs Act (IIJA) was the most significant infusion of investment in our infrastructure since the enactment of the Interstate Highway System in the mid-1950's. While the investment has had a significant impact, the funding did not go as far as Congress had hoped due to inflation and supply chain constraints. According to the Transportation Research Nonprofit TRIP, about 40% of roads in the United States are still in poor or mediocre condition. This costs

[4] Available at: https://www.agc.org/news/2024/08/28/new-survey-shows-how-nations-failure-invest-construction-education-training-programs-makes-it-hard

the average driver $621 in the form of additional repairs, accelerated vehicle depreciation, and increased fuel consumption and tire wear. The increased weight and prevalence of EVs is going to cause greater wear and tear on our roadways and require a greater investment in our roads and bridges. As such, AGC believes that Congress should:

- Increase the revenue stream for the HTF and avoid relying on the annual appropriations process to ensure road and bridge projects are not impacted by government shutdowns and spending cuts;
- Expand user fees to ensure that everyone benefiting from our transportation systems is paying their fair share through an EV user fee or a national registration fee;
- Continue research in mileage-based user fees or vehicle miles traveled (VMT) fees by continuing these pilot programs at the state and national level; and
- Maintain the excise tax on trucks and trailers unless a sufficient revenue stream is identified to replace it.

Infrastructure Investment - Electric Vehicles

The federal government provides significant tax incentives for the purchase or lease of electric vehicles. These incentives were greatly expanded in the *Inflation Reduction Act*. While some states have opted to assess an annual fee on electric vehicles, at the federal level there is currently no mechanism in place to collect revenue from these vehicles, or their users. This creates significant inequity between electric vehicles and vehicles with internal combustion engines. While both types use the national transportation and highway system, only one type pays taxes into the HTF.

In addition, EVs generally weigh more than traditional internal combustion engine vehicles, contributing to greater wear and tear on roads and bridges. This added weight not only increases the need for more frequent maintenance but also necessitates upgrades to safety features such as guardrails and barriers to accommodate the higher forces involved in collisions with heavier vehicles. As the nation's vehicle fleet becomes heavier, funding must increase to cover both the additional maintenance and the necessary safety upgrades to ensure our roads remain safe for all users.

Electric vehicles utilization has increased significantly, growing from virtually non-existent a decade ago, to 6.8 percent of the fleet as of May 2024.[5] The share is expected to grow. For example, in California—the largest car market in the country—all new passenger cars, trucks, and SUVs sold in the state will be zero-emission vehicles by 2035 under current law.

Congress could address both the inequity issue and add funding for the HTF by creating a dedicated user fee for EVs. For example, AGC supports S. 2882, the *Stop EV Freeloading Act* sponsored by Sen. Deb Fischer (R-Neb.), which would assess a tax on the battery module and sale of EVs and deposit the revenue in the HTF. Other proposals would assess a tax annually on users of EVs. While these proposals all have merit, it is imperative that Congress create an appropriate mechanism to collect this revenue to ensure that all users of the transportation system are paying into the system.

Infrastructure Investment - Financing Tools

The IIJA provided a historic increase in funding to help states and local governments invest in their roads and bridges. Unfortunately, some states have struggled to provide their required non-federal

[5] See: https://www.edmunds.com/electric-car/articles/percentage-of-electric-cars-in-us.html

match. Innovative financing tools can play an important role in improving our roads, bridges, and transit systems by helping to attract private sector investment.

However, these tools cannot be mistaken as replacements for any federal funding and require a source(s) of revenue to be paid off. Infrastructure financing can only serve as a supplement to infrastructure funding. Congress should take action to expand existing tools and consider establishing additional tools. Congress should:

- Establish other financing tools, such as a national infrastructure bank or bonding mechanism that could assist states struggling to provide the non-federal share of project funding;
- Prohibit tolling revenue from being used for non-transportation purposes;
- Reinstate the tax exemption for advance refunding of municipal bonds to allow state and local governments to refinance municipal bonds so they can take advantage of lower interest rates, as in H.R. 1837, the *Investing in our Communities Act* sponsored by Rep. David Kustoff (R-TN); and
- Provide funding to continue the Transportation Infrastructure Finance and Innovation Act (TIFIA) program and Private Activity Bonds (PABs).

Conclusion

Thank you for considering the comments of AGC of America. If you have any questions or would like to discuss these comments further, please contact Matthew Turkstra, Sr. Director of Building and Infrastructure Finance, at matthew.turkstra@agc.org.

Sincerely,

Alex Etchen
Vice President, Government Relations

Cc: Rep. Richard Neal, Ranking Member, House Committee on Ways and Means
Sen. Ron Wyden, Chairman, Senate Committee on Finance
Sen. Mike Crapo, Ranking Member, Senate Committee on Finance