



**The American Institute of Architects**

**Statement for the House  
Ways and Means Committee  
Real Estate Working Group  
on Tax Reform**

April 15, 2013

The American Institute of Architects  
1735 New York Avenue, NW  
Washington, DC 20006  
[www.aia.org](http://www.aia.org)



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The Honorable Sam Johnson  
Chair  
Real Estate Working Group  
Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Bill Pascrell, Jr.  
Vice Chair  
Real Estate Working Group  
Committee on Ways and Means  
1106 Longworth House Office Building  
Washington, DC 20515

Dear Chair Johnson and Vice Chair Pascrell:

On behalf of the American Institute of Architects and its more than 81,000 members, I am pleased to submit this statement to the Ways and Means Committee's real estate working group on tax reform.

We look forward to working with you and the members of the Committee over the coming weeks and months to ensure that comprehensive tax reform helps move our country forward.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Goldberg".

Andrew L. Goldberg  
Managing Director, Government Relations and Outreach

## Executive Summary

The American Institute of Architects (AIA) has been the leading professional membership association for architects and allied partners since 1857. The AIA represents more than 81,000 architects and emerging professionals nationwide and around the world.

The AIA supports comprehensive tax reform that broadens the base, lowers rates, and maintains parity among corporate and pass-through entities. The AIA urges Congress to ensure these three principles are reflected in comprehensive tax reform:

- Preserve tax policies that support and strengthen small businesses, which account for the vast majority of U.S. architecture firms;
- Consider tax policies that support innovative, economically vibrant sustainable, and resilient buildings and communities; and
- Ensure fairness in the tax code.

Nearly all architecture firms are small businesses, and a significant portion are organized as pass-through entities. The AIA believes that it is imperative that tax reform is comprehensive. “Corporate-only” tax reform would leave pass-through entities at a severe disadvantage, harming small businesses, including architecture firms.

As tax reform progresses, it is important to consider tax policies that support innovative, economically vibrant, sustainable, and resilient buildings and communities. The AIA urges Congress to make a particular effort to continue and improve tax policies aimed at energy efficiency. One such example is the Energy Efficient Commercial Building Tax Deduction (IRC §179D); in the case 179D is retained close to its current form, we strongly urge Congress to make permanent and enhance it by: (1) ensuring the ability of pass-through entities to capture the full value of an allocated deduction in the case of a public owner; (2) allowing non-profit owners of buildings, similar to public owners of buildings, to allocate the deduction; and (3) increasing the value of the deduction.

Lastly, it is important that tax reform preserve and improve fairness in the tax code. A tax policy of significant interest to the architecture industry is the Domestic Production Activities Deduction contained in section 199 of the IRC. Proposals have been offered to repeal or reform section 199. Proponents of such proposals assert that repealing section 199 could provide revenue to offset the cost of lower marginal tax rates. However, we urge that, if section 199 is retained in some form, that it be retained for currently-eligible trades and businesses, including architectural services.

## Introduction

The American Institute of Architects (AIA) commends the House Ways and Means Committee for its work on the critical issue of tax reform. Thank you for the opportunity to submit this statement.

AIA supports comprehensive tax reform that lowers marginal tax rates for individuals, pass-through entities, and corporations, while broadening the tax base and simplifying the tax code.

We recognize that tax reform is a balancing act. Lowering tax rates will require curtailing or discarding many tax expenditures, while maintaining and improving a limited number of tax policies that support important policy objectives. We are hopeful that, at the end, tax reform is an opportunity to provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

This statement begins with a description of the architecture profession, followed by our comments on tax reform. In short, we urge Congress to:

- Preserve tax policies that support and strengthen small businesses, which account for the vast majority of U.S. architecture firms;
- Consider tax policies that support innovative, economically vibrant sustainable, and resilient buildings and communities; and
- Ensure fairness in the tax code.

## The American Institute of Architects (AIA)

The AIA has been the leading professional membership association for architects and allied partners since 1857. The AIA represents more than 81,000 architects and emerging professionals nationwide and around the world.

In 2011 alone, the 17,500 architecture firms owned by AIA members grossed billings of \$26.0 billion,<sup>i</sup> driving economic activity and job growth. Moreover, most architecture firms at which AIA members work are small businesses, with nearly 97 percent of firms having fewer than 50 employees.

Architecture is about more than just buildings. At a time when our nation faces great challenges that require innovative, forward-thinking solutions, architects are in the business of creative problem-solving. Architects work to advance our quality of life through their commitment to healthy, safe, resilient and sustainable communities. From designing the next generation of energy-saving buildings to making our communities healthier and more vibrant, from helping neighborhoods rebuild after disasters to exporting American design know-how to the rest of the world, architects turn dreams and aspirations into reality.

## **Preserving Small Businesses**

As Congress moves forward with tax reform, tax policies aimed at strengthening small businesses-- including tax policies that maintain the ability of businesses to choose pass-through forms of entities -- should be preserved.

As noted above, nearly all architecture firms are small businesses with fewer than 50 employees. A significant portion of these firms are organized as pass-through entities, including partnerships and S corporations.

We appreciate the House Ways and Means Committee's release of the Small Business Tax Reform Discussion Draft. We continue to analyze the impact that the Discussion Draft's proposals would have on AIA members.

In the meantime, it is imperative that tax reform is comprehensive, addressing tax issues for individuals, pass-through entities, and corporations. "Corporate-only" tax reform would leave pass-through entities at a severe disadvantage, harming small businesses, including architecture firms.

We also urge Congress to preserve tax policies that are aimed at strengthening small businesses, reducing compliance burdens, and providing certainty. Such policies would help spur economic activity by helping small businesses expand operations and drive job creation by allowing small businesses to hire new workers and increase wages and benefits.

## **Supporting a Vibrant Built Environment**

As tax reform progresses, it is important to consider tax policies that support innovative, economically vibrant, sustainable, and resilient buildings and communities.

In its current form, the Internal Revenue Code (IRC) contains a number of important tax provisions that impact development generally. These include policies such as:

- The mortgage interest and insurance deductions (IRC § 163)
- Depreciation deductions (IRC § 168)
- Tax-exempt bond financing (IRC § 142)
- Real estate investment trusts (IRC §§ 856-857).

Additionally, the IRC contains a number of tax policies aimed at incentivizing important development objectives. These include provisions such as:

- Rehabilitation Credit (IRC § 47)
- Low-Income Housing Tax Credit (IRC § 42)
- Expensing of Brownfield Remediation (IRC § 198)
- New Markets Tax Credit (IRC § 45D).

Each of these provisions provides important support for the design, construction, and renovation of buildings of different types. However, the complexity of the tax code, inconsistency in the requirements and metrics of differing provisions, and a lack of policy coordination between them often blunts their impact. As the AIA's 2010 study [\*Promoting Livable Communities\*](#) notes:

There are hosts of tax policies that impact real estate generally. However, because there was no overarching federal vision for livability at the time of their development, the incentives tend to address single pieces of the larger picture and have a strong focus on individual buildings, making it difficult for communities and developers to use the tax policies to create livable, sustainable patterns of development.

Tax reform presents the opportunity to review these policies, identify important policy objectives, and develop and improve tax policies that empower building owners and their communities to achieve these objectives.

In this regard, we urge Congress to make a particular effort to continue and improve tax policies aimed at energy efficiency. We would like to note that AIA has been working on this issue with other design and construction industry stakeholders, who have submitted to the House Ways and Means Committee Working Groups a joint statement in support of IRC section 179D.

Currently, the Energy Efficient Commercial Building Deduction, which is contained in section 179D of the tax code, has been an extremely effective tool in increasing the energy efficiency of buildings. Section 179D has leveraged billions of dollars in private capital, resulting in the energy-efficient construction and renovation of thousands of buildings, while creating and preserving hundreds of thousands of jobs. It is one of the best examples of the tremendous impact tax incentives can have on financing energy-efficient property.

Section 179D's success demonstrates the strong need to retain an energy efficiency provision in the tax code in some form. In the case section 179D is retained close to its current form, we strongly urge Congress to make permanent and enhance the section 179D deduction by: (1) ensuring the ability of pass-through entities to capture the full value of an allocated deduction in the case of a public owner of a building; (2) allowing non-profit owners of buildings, similar to public owners of buildings, to allocate the deduction; and (3) increasing the value of the deduction.

#### Allocating the Section 179D Deduction to a Pass-Through Entity.

Section 179D provides a federal, state, or local government owner of a commercial building an election to allocate the tax deduction to the primary person responsible for designing the energy-efficient enhancements. In December 2010, the Internal Revenue Service (IRS) released a memo that effectively prevents firms organized as partnerships or S corporations from fully realizing the benefit of an allocated section 179D deduction.<sup>ii</sup>

In order for partnerships and S corporations to obtain the intended benefits, it is necessary for partners and S corporation shareholders to obtain a basis in their partnerships and S corporations that is not reduced by an allocated section 179D deduction. This issue could be addressed by a simple statutory modification to expressly require the Department of Treasury to issue regulations that properly determine partnership or S corporation outside basis in the case where section 179D is allocated. Such a clarification would provide certainty and address a widespread concern among many small businesses that design energy-efficient buildings.

#### Allocating the Section 179D Deduction in the Case of a Non-Profit Owner of a Building.

In many cases, non-profit entities, such as hospitals, universities, private schools, charities, and foundations, conduct functions similar to state and local governments. Currently, non-profit entities own thousands of properties across the country. Although retrofits to these properties could result in significant energy savings, the non-profit entities do not pay taxes and, consequently, cannot benefit from section 179D.

The section 179D allocation provision should be expanded to provide non-profit owners of buildings, similar to public owners of buildings, with the ability to elect to allocate the deduction to the primary designer of the building. Such a provision would assist non-profits in financing energy-efficient upgrades and would reduce their energy costs in the longer-term.

#### Enhancing the Section 179D Deduction.

The maximum section 179D deduction of \$1.80 per square foot has not been increased since the deduction was put in place in 2005 and, as a result, has not kept pace with inflation. Consequently, the impact of section 179D has become diminished over time.

In 2010, a coalition of more than 80 organizations and companies called on Congress to increase section 179D from the current maximum allowable amount of \$1.80 per square foot to \$3.00 per square foot. In the case of individual subsystems, the maximum allowable deduction should be increased from \$0.60 per square foot to \$1.00 per square foot. Bipartisan legislation was introduced in the Senate in the 112<sup>th</sup> Congress to enhance the deduction in this way (S. 3591).

Enhancing section 179D would provide an important source of additional capital to stimulate building design, construction, and renovation, driving the creation of well-paying jobs. An enhanced 179D deduction would further incentivize energy efficiency, improve the nation's commercial building stock, and increase energy independence.

## **Ensuring Fairness**

It is important that tax reform preserve and improve fairness in the tax code. In this regard, a tax policy of significant interest to the architecture industry is the Domestic Production Activities Deduction contained in section 199 of the IRC.

Proposals have been offered to repeal or reform section 199. Proponents of such proposals assert that repealing section 199 could provide revenue to offset the cost of lower marginal tax rates. However, we urge that, if section 199 is retained in some form, that it be retained for currently-eligible trades and businesses, including architectural services.

By way of background, section 199 was designed as a replacement for previous U.S. programs that were deemed illegal by the World Trade Organization (WTO) and were repealed. In 2004, Congress enacted section 199 to replace these programs. The deduction was established to enhance the ability of U.S. manufacturing and other businesses “to compete in the global marketplace,” and because “Congress should enact tax laws that enable small businesses to maintain their position as the primary source of new jobs in this country.”<sup>iii</sup>

Facing intense international competition, architectural services were covered by section 199, as they were previously by the predecessor DISC, FSC, and ETI programs. Senator Kay Bailey Hutchison (R-TX), a strong proponent of the architectural services inclusion, said at the time:

We know there has been a huge outsourcing of professional jobs overseas. This is becoming more common. Our architectural and engineering firms are particularly vulnerable to foreign competition.<sup>iv</sup>

The need that section 199 is aimed at addressing continues to exist today and, in fact, is more pronounced. U.S. companies continue to face a competitive disadvantage internationally due to the tax system. This applies to the architecture industry.

Consequently, if section 199 is retained, we urge that it be retained for currently-eligible trades and businesses including architectural services. Narrowing section 199 would result in some industries doubly benefitting, while others are harmed. Industries included in section 199 would not only receive the section 199 deduction, but also benefit from the, albeit small, across-the-board marginal tax rate cut offset by excluding industries. In contrast, those industries excluded from section 199 would lose the section 199 deduction and receive only a small marginal tax rate cut, insufficient to compensate for the loss.

## Conclusion

The AIA appreciates the opportunity to submit this statement to the House Ways and Means Committee Working Groups.

As Congress considers tax reform, we urge: preserving tax policies support and strengthen small businesses; considering tax policies that support innovative, smart, energy-efficient, and resilient development; and ensuring fairness in the tax code. Tax reform following these principles would provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

The AIA and its members are ready to serve as a resource to Congress, the Committee, and the Working Groups on these and other issues.

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<sup>i</sup> AIA, *The Business of Architecture: 2012 AIA Survey Report on Firm Characteristics* (2012).

<sup>ii</sup> I.R.S. Chief Couns. Mem. AM2010-007 (Dec. 23, 2010).

<sup>iii</sup> Joint Comm. on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress*, at 170 (May 2005)

<sup>iv</sup> Cong. Rec. S5200 (daily ed., May 11, 2004) (statement by Sen. Hutchison).