



# THE Architect's Guide to R&D Tax Credits

Recognize which of your activities qualify for R&D tax credits.



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Innovation Partner

## Introduction

Federal research and development (R&D) tax credits have been available to businesses for more than three decades. Even so, many architects simply don't realize the tax credits are available to them or don't understand which activities qualify. While the Tax Cuts and Jobs Act (TCJA) made many changes to our tax code, it retained the permanency of R&D credits, underscoring the importance of U.S. investments toward innovation. Architects as well as engineers and contractors qualify for these valuable tax credits, which can add up to tens of thousands of dollars in tax savings.

This e-book is designed to help you recognize which of your activities qualify for R&D tax credits, what the qualification process entails and how a qualified R&D tax partner can help ensure you are receiving all available credits to reinvest in your business.

Topics include:

- The Evolution of R&D Tax Credits
- Understanding the Four-Part Test
- The Opportunity for Architects and Engineers
- Working With an R&D Tax Credit Partner

We hope the following information is helpful. We welcome your questions!



# CHAPTER 1

## The Evolution of R&D Tax Credits

When the federal government implemented the Research and Experimentation credit in 1981, the program was meant to be a temporary incentive to boost technology. After being extended numerous times over the years, the R&D tax credit – as it came to be known – is now a permanent tax incentive meant to stimulate innovation, technical design and manufacturing within the country and keep the U.S. on the forefront of advancement. And while the last major tax reform in 2017 included many changes to the tax code, it retained this important incentive.

Some individual taxpayers were prevented from using the tax credit in the past because of the alternative minimum tax, or AMT. Now that AMT exemptions are increasing for individual taxpayers, they are more likely to take advantage of R&D tax credits that pass through to them via their business. Additionally, the TCJA eliminated the corporate AMT, but there are still some limitations which prevent taxpayers from using the R&D tax credit to totally eliminate their tax liability.

Two-thirds of U.S. states also offer tax credits for R&D activities. Like the federal program, the state incentive is designed to reimburse companies that develop new products, processes or inventions. The incentive offers a significant percentage back to the company for qualified research activities and qualified research expenses (QRE). These savings can offset wages and salaries paid for qualified activities, and even research that is contracted out to third parties.

There are some common misperceptions about R&D tax credits that often keep architects and engineers from applying. First, many believe R&D is limited to scientists and medical researchers. Nothing could be further from the truth. Today R&D tax credits are available for a host of business activities that can prove they are meeting the intent of the incentive. In fact, your company no longer needs to develop a product or process that is new to their industry; it only needs to be new to them. For example, an engineering firm can qualify for alternative structural design or for improving HVAC systems in a building.

*Less than **one-third** of eligible companies realize they qualify for the valuable R&D tax credit.*

Another misperception is that you need to be a large company to qualify. If you are conducting activities that promote advancements as defined by the state and/or the IRS, your business has a good chance of capturing well-earned credits. Even if your firm is new and you do not yet have revenue, there are opportunities to earn credits for R&D activity.

So how can you ensure your firm is capturing all potential R&D tax credit dollars to which you are entitled? Partnering with R&D tax experts will ensure that you capture all eligible credits and have the documentation to back up your claims. These experts conduct a comprehensive R&D tax credit study, drawing on a team of CPAs, attorneys and engineers, to identify all qualifying activities, which we'll explain in detail in Chapter Three. As we will see in the next chapter, it is helpful to understand the criteria the federal government uses to determine eligibility.



## CHAPTER 2

### Qualifying: Understanding the Qualitative Four-Part Test

Like many business owners, architects often don't know what the government requires for R&D tax credit eligibility. A simple four-part test helps to determine which activities constitute qualified research according to criteria established by the IRS:

- 1) **Permitted Purpose/Business Component:** The activities must relate to new or improved business components, function, performance, reliability and quality. Again, the innovation doesn't need to be new to the architecture industry, just new to your firm's processes and procedures. And even if the activity doesn't come to fruition, it can still qualify. As defined in the IRS regulations, the business components include a product, process, technique, invention, formula or software.
- 2) **Technological in Nature:** The activity performed must fundamentally rely on the principles of physical or biological science, engineering or computer science. It is useful to know that these three principles can cross into many industries. The many aspects of engineering apply to architecture and structural engineering and a host of other industries and services. What's more, the definition of computer science includes third-party sale, lease and license software as well as internal use software, which a company uses to monitor or develop its own processes.

**3) Elimination of Uncertainty:** There needs to be some uncertainty at the onset when the company is trying to develop a new or improved business component. However, there only needs to be uncertainty regarding one of three things:

- Can they do it?
- How would they do it?
- What is the ultimate or appropriate design of what they are trying to develop?

In other words, the activity must be intended to discover information to eliminate uncertainty concerning the capability, method or design for developing or improving a product or process.

**4) Process of Experimentation:** The company needs to evaluate different alternatives when it is trying to develop the new or improved business component. This evaluative process must be capable of identifying and evaluating more than one alternative to achieve a result. This may include modeling, simulation or a systematic trial and error methodology. The costs of design, construction and testing of pre-production prototypes and models can also qualify.

Now that you have a better sense of how to qualify, let's get to the heart of the matter. Which of your activities stand a good chance of qualifying for R&D tax credits?



## CHAPTER 3

### **The Opportunity: Architects and Engineers**

Even though architecture and engineering have been approved sciences in the IRS code for years, Engineered Tax Services still talks to firms that have no idea their projects or activities qualify. For example, many phases of architectural design, such as conceptual, schematic and design development, require extensive research to identify solutions to design problems. You can also qualify if you test alternative methods of design, ranging from energy use, regulatory requirements or designing for a space for complex business such as technology or medical use.

The following represents a sample list of qualifying activities for architects:

- Developing unique energy-efficient features
- Developing schematic designs
- Developing site plan to overcome site features
- Developing elevation drawings for planning
- Designing unique lateral force resistance systems
- Developing plans to meet unique/specific load requirements
- Determining alternative materials to improve design or meet specific requirements

- Improving acoustical qualities of a structure
- Developing unique heating, cooling or ventilation systems
- Achieving LEED certification

Engineers also conduct a host of R&D activities that may qualify for R&D tax credits. Some of the typical activities include:

- BIM Modeling – Designing a building collaboratively with one system of computer models
- Determining alternative structural design
- Improving or determining substitute HVAC systems
- Developing or improving lighting
- Sustainable design
- Value engineering
- Space management to determine the type and scale of facilities
- Development of alternative water flow/plumbing systems
- New material testing – Measurement of the characteristics and behavior of such substances
- Environmental design
- Environmental impact studies

If your architectural or engineering firm is focusing on sustainable and green designs to incorporate into building features, this activity may also make you eligible to receive R&D tax credits.

## Retroactive Claims

Did you conduct activities in the past but did not pursue the R&D tax credit? While you can't claim the credit to offset your payroll tax, you can have a tax expert perform a "look back" to claim up to three years of uncaptured tax credits. To claim the federal R&D tax credit retroactively, you need to file amended returns. You can do the same in many states that offer R&D tax credits. In fact, in some states you are able to go back more than three years to recover taxes you previously paid.

## Credit Carryforward

If your qualified small business did not earn revenue but conducted eligible R&D activities, the credit can be taken as a payroll tax offset up to \$250,000 per year by qualified small businesses with less than \$5 million in revenue and within five years of your first gross receipt. If you are unable to use earned tax credits, such as in the case

of business losses, you can typically carry forward credits for up to 20 years. These credits can result in significant refunds from prior years and a substantial reduction in federal and state income taxes in the current and future years. Just be sure to document your activities and expenses.

*A significant change is the reduction in the corporate income tax rate to a flat **21%** from the top rate of **35%**.*

The Tax Cuts and Jobs Act (TCJA) included changes that affect R&D tax credits—most for the better. The following is a summary of tax reform changes as they affect the R&D tax credit.

- **Corporate Tax Rate Changes**

A significant change is the reduction in the corporate income tax rate to a flat 21% from the top rate of 35%. Because the IRS code requires taxpayers to reduce the amount of the R&D credit by the maximum tax rates, corporations can now benefit from an enhanced deduction. Whereas taxpayers previously only recognized a net benefit from this credit of 65%, the benefit has now increased to 79%.

- **AMT Changes**

Tax reform also eliminated the corporate alternative minimum tax (AMT) and increased the exemptions and phaseout amount for individual AMT. That means that R&D tax credits can now be used to offset AMT in addition to federal income tax. Keep in mind that corporate taxpayers still must adhere to tax law that specifies that a credit cannot exceed certain limits. For passthrough entities, more individuals will be eligible to benefit from R&D credits given that fewer individuals are subject to AMT provisions.

- **Net Operating Loss (NOL)**

Before tax reform, taxpayers could offset 100% of taxable income through NOLs. After Dec. 31, 2021, NOLs can only be used to offset 80% of taxable income. The good news is that taxpayers can use the R&D tax credit to further offset any remaining tax liability.



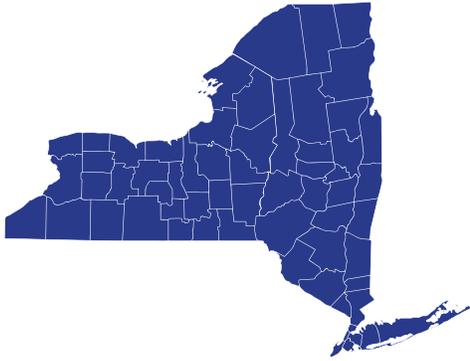
## CHAPTER 4

### Working With an R&D Tax Credit Partner

The R&D tax credit provides an excellent source of cash to reinvest in your business as well as a reduction to current or future tax liabilities. This valuable tax credit is often overlooked because either architects don't realize their activities qualify or they perceive the documentation process to be too tedious. That's why it is critical to engage the services of a qualified R&D tax credit professional with expertise in helping architects successfully claim these valuable tax credits.

#### The R&D Tax Credit Study

Claiming R&D tax credits requires substantial documentation to prove that your work meets the criteria for eligibility established by your state and the federal government. A professional R&D tax expert will conduct a tax credit study, which is a comprehensive analysis of your firm's R&D activities. During the study, the tax expert will document your activities and be prepared to defend your claims should federal or state taxing authorities initiate an audit.



## R&D TAX CREDIT CASE STUDY FOR ARCHITECT IN NEW YORK

1-year tax savings: \$211,969 (federal only)

Study Highlights	
Wages	\$3,734,124
Supplies	\$0
Contract Research	\$407,207
Total Qualified Research Expenditures	\$4,141,331



## R&D TAX CREDIT CASE STUDY FOR ARCHITECT IN GEORGIA

3-year tax savings: \$90,455 (federal & state)

Study Highlights	
Wages	\$1,207,043
Supplies	\$0
Contract Research	\$551,909
Total Qualified Research Expenditures	\$1,758,952

*There is a direct correlation between the amount of your defensible credit and the expertise of the advisor performing the tax credit study.*



## **Thorough R&D Tax Credit Expertise**

It is essential to seek professional help from an R&D consultant with a strong expertise in helping architects successfully claim these valuable tax credits. For example, at Engineered Tax Services, our R&D experts delve deeply into the fundamentals of your business activities—incorporating operations, engineering, financial and tax expertise that results in more credits and meticulous documentation that is necessary to support your activities, costs and credit.

Look for an expert who can provide exceptional references for R&D work in the architecture and engineering industries. You'll also want a team with resources throughout the U.S. and a solid reputation for being able to defend R&D tax credit studies.

## Conclusion

As we addressed at the beginning of this e-book, the concept of the R&D tax credit is straightforward—the government will reward you for innovative work if you meet eligibility requirements. The R&D credit allows companies to realize tax savings, increase cash flow and stay competitive in the marketplace.

Engineered Tax Services partners with architects, engineers and contractors nationally to provide independent, third-party certification as required by the IRS to help them take advantage of significant tax benefits.

The R&D tax experts at Engineered Tax Services have helped companies of all sizes across the U.S. identify and qualify these expenditures and receive the tax benefits they have been missing. Our process begins with a no-cost [R&D Tax Credit Qualification Analysis](#) to make sure your company qualifies for the R&D tax credit.

To learn more about [R&D tax credits for architects](#), please complete the form on this page. For immediate questions about tax deductions for architects, call Engineered Tax Services at (800) 236-6519 or check out our [R&D tax credit services](#) for more information.



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