

# Construction

## Accounting and Taxation

# The R&D Tax Credit: Basics for Construction Business Owners

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As construction companies look at improving their bottom lines, there is a growing recognition that any tax relief coming from Washington, D.C., could be very limited. Instead, smart business owners within the industry are looking harder at whether they can qualify for already existing tax credits and incentives—and the first place they should look is the Research and Development (R&D) Tax Credit.

### **Biggest tax credit for businesses**

The R&D Tax Credit is the largest federal tax credit available for businesses, bringing in approximately \$10 billion each year in tax savings. In addition, nearly 40 states have their own versions of the credit, providing business owners with additional tax savings at the state level. While large corporations are very active in taking the R&D Tax Credit, the sad reality is that thousands of small and medium-sized businesses fail to take advantage of this incentive. This is particularly frustrating because these businesses are engaged in activities that qualify for the credit. Hardly a day goes by that I don't see a small or medium-sized business owner who is eligible for the R&D credit overlook what can often be significant tax savings.

Why do so many small and medium-sized businesses fail to take advantage of the R&D Tax Credit? It traditionally comes down to two reasons: (1) education (the business owner is unaware of the credit), and (2) self-censoring (even if the business owner is aware of the credit, the owner believes that his or her business does not qualify). By reading this article, you've eliminated the first problem: education. Now you know about the R&D Tax Credit, so there are no excuses on that front. So let's address the second issue: self-censoring.

### **How to qualify**

At its simplest level, the R&D Tax Credit is about encouraging basic science and/or applied science. It is the applied science piece that most construction companies do not understand about the R&D credit, thinking that

eligibility is only about test tubes and lab coats. Congress wanted to encourage not only basic research but also applied research. If your business is involved in applied research—which entails making a product or improving a product (e.g., version 1.0, 2.0, and 3.0)—or if your business is improving how it makes a product (e.g., cheaper, faster, cleaner, greener), then you may be engaged in activities that qualify for the R&D Tax Credit.

For a better understanding of what qualifies for the credit, let's take a real life example. For four years' worth of eligible building projects and construction services, one general contractor received over \$584,000 in federal credits. Among a host of qualifying projects, this company provided construction services for an assisted-living facility, a project that required the construction of six different two-story buildings.

This project qualified for the credit due to the practical and technical problem solving that is quite common at the average construction site. In this particular instance, the company was forced to overcome challenges related to the foundation of the building. Once the company arrived on site, they quickly found that the foundation was not level and that the shape and design of the building they were originally contracted to build would not be structurally sound. As a result, the company was forced to change their plans on the fly, analyzing the original designs and making adjustments to the exterior walls and floors to ensure they were on par with local building codes. The company also evaluated alternative building solutions, ultimately settling on roof, floor, and wall systems that were in accordance with local building ordinances.

### **Don't self-censor**

One way to think of the credit is to ask yourself this simple question: Has your company been making buildings the exact same way for the past five years? If your response is, "My company is constantly changing," or, "My company is always innovating, improving, and modernizing its approach to creating and renovating buildings," then the R&D Tax Credit is worth a hard look.

Another common misconception about the credit is that the work of your business has to be new to the world (think Nobel Prize, curing cancer, etc.). No, no, no. The requirement is that your R&D has to be new to your business.

Finally (and an extremely important point to construction companies working on a contractual basis), some business owners think that because their companies are being paid to perform the work, they can't qualify for the R&D Tax Credit. In a large number of these cases, your company will still be able to get the credit, although the contract needs to be reviewed in terms of who bears risk and who retains rights (lawyers need to work as well).

### **Businesses that are good candidates for the R&D credit**

The amount of innovation that goes on in this country, in a wide range of industries, is sometimes eye opening to me—and construction companies are among the leaders in creating tomorrow's newest trends. For their everyday innovations, companies within these sectors of the construction industry can qualify for the R&D Tax Credit, saving these businesses hundreds of millions of dollars in the process. Qualifying companies in the past have been involved in:

- Architecture
- Civil Engineering
- Construction
- Electrical Contracting

- Electrical Engineering
- Environmental Engineering
- General Contracting
- Mechanical Contracting
- Mechanical Engineering
- Structural Engineering

This list gives only a general idea of what types of construction-related activities qualify, as I have seen a number of companies not on this list claim the credit. It just goes to show the importance of keeping an open mind when evaluating eligibility for the credit.

### Next steps

The question I often get from business owners is, “Why haven’t I heard about the R&D Tax Credit before?” or “Why didn’t my financial advisor tell me about this?” The reality is that there have been a number of changes to the laws, regulations, guidance, and court decisions over the past several years, including some important changes just in the last year or so. The general thrust of these changes has been to make the R&D Tax Credit friendlier to businesses—especially small and medium-sized businesses. In addition, Congress extended the credit late last year, so now is the time for a new look to see if your company qualifies (and don’t cry too much over spilled milk—you can usually amend your tax returns for the past three years and get the benefit of the R&D Tax Credit that you’ve been missing).

I suggest that the first step for a construction business owner is to talk to his or her CPA or specialty tax services provider and see if the R&D Tax Credit makes sense for the company. After a brief conversation, a tax expert knowledgeable about the R&D Tax Credit can quickly determine whether the business has enough “there there,” in terms of both the activities of the business and the tax position of the owners, to warrant a fuller review of credit qualification. Hopefully, you will find that, like thousands of other business owners across the country, thanks to the R&D Tax Credit you now have more black ink on your bottom line—black ink for improving and expanding your business as well as hiring and training new employees.



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