

Research & Development

A Tax Credit Case Study: Construction Industry

Company Overview:

Jones Construction Corporation is a large family-owned construction company based in southern New England with average annual revenues around \$160 million. The company has multiple divisions and performs various construction engineering services on public and private projects throughout the region. Projects range from bridge design/build to highway paving for the DOT. All construction projects the Company works on are large in scope and require the Company to coordinate efforts with numerous engineering and regulatory entities. To bid and perform these jobs, Jones Construction relies on a team consisting of estimators, project engineers, superintendents, and foremen. Various members of the team in each department hold engineering degrees.

R&D Credit Analysis:

Alternate Tax Solutions (ATS) was contracted by Jones to review its operations within the time frame of 2015-2018 to determine if any expenses were eligible for the R&D Credit. ATS reviewed each division of the Company to determine whether or not projects and activities in each division could meet the *four-part* test established by Section 41 of the Internal Revenue Code. Tax Court rulings surrounding contracted research were also used as a guideline, as well as the *IRS Audit Techniques Guide*.

Qualified Research Findings:

Heavy Highway and Bridge Construction Contracts: ATS found that Jones Construction's work to develop construction solutions needed for bids and for projects requiring the construction of critical highway infrastructure and bridges met the *four-part* test. On these projects, the Company was either 1) responsible for developing the construction processes needed to physically build the structures that had been designed by government engineers or 2) responsible for developing the engineered designs and the construction solutions needed to complete the project (design/build contracts). All of this work was done under fixed-price contracts that required Jones to submit its solutions for inspection and testing at various stages. The engineering team of estimators, project engineers, superintendents, and foremen all engaged in a process of experimentation to eliminate the numerous uncertainties on each project.

Materials Division: Jones utilized a materials division consisting of an open-pit mining operation, asphalt plant, and concrete plant to produce aggregate mixes needed to sell concrete and asphalt that would meet specific performance requirements. Diligentiam found that there was a core management and laboratory team responsible for developing and testing formulas to produce new products throughout the year. This was found to constitute qualified research.

Paving Division: Jones operates a paving division that performs milling and paving on state, municipal, and private contracts. No qualified research activities or expenses were found in this division.

Qualified Research Activities (QRAs):

In its review of the processes utilized by Jones to deliver construction solutions under contract, as well as select projects from each year, ATS found that the following activities were associated with qualified research:

- Analyzing alternative construction process approaches in the bidding and estimating phase
- Performing the takeoff calculations needed to evaluate each alternative
- Developing structural and civil engineering designs needed to meet project requirements
- Utilizing third-party engineers to perform the design and calculations necessary for specialty components of a project
- Utilizing CAD to model alternative system components and sub-components to test construction plans against the end-state requirements
- Reviewing and identifying uncertainties with the engineered plan
- Utilizing team meetings to review all construction process hypotheses
- Evaluating lean construction processes
- Modeling of cuts, fills, and elevations in Ag-Tech software
- Identifying value-engineering alternatives to drive down costs and increase efficiency
- Pre-construction planning meetings
- Performing tests to identify geotechnical conditions on site
- Identifying uncertainties with the construction plan during the build phase of the project
- Redesigning construction plans and designs and submitting for approval
- Final tests and inspections
- Correcting deficient work

Qualified Research Expenses

ATS developed a methodology to calculate the qualified wage, contractor, and material expenses associated with qualified research across the company. Since the personnel responsible for performing qualified research (superintendents, engineers, estimators, and supervisors) did not log hours toward projects, ATS established a nexus by quantifying hours and time spent engaged in each qualified activity. This was done through interviews, surveys, and review of contemporaneous documentation.

R&D Credit Results:

ATS was able to utilize the revenues and expenses in years prior to 2016 to calculate the R&D Credit using the Regular Method for start-up companies, as well as the Alternative Simplified Credit Method. Since the Company had never claimed the Credit under the Regular Method on any amended returns, it would be able to use whichever calculation produced the highest results.

Tax Year	2015	2016	2017	2018
Total QREs	\$2,221,412	\$2,517,343	\$2,838,791	\$3,707,131
Total Tax Credit	\$ 222,141	\$ 251,734	\$ 283,879	\$ 370,713
Net Tax Benefit	\$ 144,391	\$163,627	\$224,264	\$ 292,863

*State R&D Credits were not available for pass-through entities in these years

Conclusion:

Jones Construction was able to amend returns to claim R&D Credits and obtain refunds checks for tax over-payments. Through an in-depth analysis of all operations at the Company by R&D Credit subject matter experts, Jones Construction was able to maximize its R&D Credit while ensuring that it avoided claiming any expenses that would be disallowed under review by the IRS.



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