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Research and Development Tax Credit

The Challenge

Many architecture firms, especially small and medium-sized businesses, face challenges when leveraging the R&D tax credit due to restrictive eligibility criteria and high costs associated with compliance. Clarifying architects access to this credit will fuel broader innovation across the industry, empowering firms to invest in sustainable and cutting-edge designs.

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BACKGROUND

The Research and Development (R&D) tax credit, established under Section 41 of the Internal Revenue Code in 1981, is designed to incentivize businesses to invest in innovation and technological advancement. Originally designed to encourage technological advancement, the credit has become increasingly applicable across industries, including architecture. Qualifying Research Activities (QRAs) for the credit often involve developing new or improved products, processes, or techniques, which can include design enhancements, innovative material applications, and energy-efficient solutions.

WHY IS THE R&D TAX CREDIT NEEDED

The R&D tax credit is essential for driving innovation, economic growth, and global competitiveness, particularly in industries like architecture. By incentivizing investment in new ideas, materials, and processes, the credit encourages firms to develop cutting-edge advancements such as sustainable building designs, innovative construction techniques, and enhanced digital modeling capabilities. For small and medium-sized architecture firms operating on limited budgets, the credit reduces financial risk and enables reinvestment in talent, tools, and energy efficient design innovation. Beyond fostering innovation, the credit stimulates economic growth by allowing firms to expand operations, create high-paying jobs, and invest in workforce development. Additionally, as other countries offer generous R&D incentives, maintaining and expanding the U.S. credit is crucial for keeping American businesses competitive in a global market. Without it, firms may outsource innovation or struggle to keep pace with international advancements. In an unpredictable economy, accessible and predictable tax incentives provide financial stability, ensuring that architecture and other innovation-driven industries can continue to be competitive and grow the economy.

THE ASK

Congress should:

1. Clarify the eligibility criteria for the credit by explicitly listing design and architectural innovations, allowing firms to claim the credit for a broader range of design activities.

2. Extend the credit to include costs associated with initial concept development and building information modeling (BIM) software.

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Research and Development Expensing

The Challenge

Under current rules, firms may be required to amortize R&D expenses over several years, delaying the financial benefits of these deductions. Immediate expensing of these costs is critical for small and medium-sized firms, allowing them to reinvest savings into cutting-edge designs, sustainable technologies, and advanced software, fostering industry growth and innovation.

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BACKGROUND

Research and Development (R&D) expensing allows businesses to deduct their R&D costs in the same year they are incurred, offering immediate financial relief. This approach is particularly beneficial for projects requiring substantial upfront investments in technology, experimentation, and other innovation-focused activities. However, starting in 2022, changes to federal tax law have required companies to amortize their R&D expenses over five years, rather than expensing them immediately.

WHY SHOULD CONGRESS FIX R/D EXPENSING

The shift from immediate expensing to amortization over five years increases the financial burden on firms, particularly small and medium-sized architectural practices. Reinstating immediate R&D expensing would enhance cash flow, allowing these firms to invest more readily in innovative designs and sustainable technologies.

Architectural firms often face significant upfront costs in research and design processes. R&D expensing provides immediate tax deductions for these expenses, aiding cash flow and reducing taxable income. Key benefits include:

- Supporting investments in innovative and experimental designs.
- Reducing the financial burden of early-stage projects.
- Enabling firms to reallocate savings into further innovation and sustainability initiatives.

THE ASK

Congress should:

1. **Permit immediate expensing** of all R&D-related costs, including design and conceptual work, to improve cash flow and support innovation in architecture.
2. **Extend the scope of R&D expensing** to include training costs for new sustainable technologies or specialized design software critical to the industry.

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Low-Income & Workforce Housing Tax Credits

The Challenge

The need for affordable and workforce housing is at a critical high. Expanding LIHTC funding and establishing a Workforce Housing Tax Credit program will empower developers to work with architects to initiate additional projects. Allowing architectural firms to directly benefit from these programs would further incentivize innovative design services for affordable housing.

The Ask

Increase funding and expand LIHTC to support more low-income housing projects.

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BACKGROUND

Low Income Housing Tax Credits (LIHTC) incentivize developers to build and rehabilitate affordable rental units. The program provides a non-competitive 4 percent or competitive 9 percent credit for the production of housing affordable to low- and moderate-income people. It is the largest federal program designed to encourage affordable housing development by the private sector, and since its inception in 1986 it has financed over three million apartments and served 7 million households.

LIHTC credits make affordable housing development viable. By offsetting project costs in exchange for reserving a portion of units for low-income renters, the program stimulates private sector investment and delivers housing options that people can afford.

While there is no federal Workforce Housing Tax Credit, local jurisdictions are providing Workforce Housing Tax Credits to address the needs of middle-income residents. Together, these programs are critical to addressing the national housing shortage and promoting equitable access to affordable homes.

WHY IS LIHTC REFORM NEEDED?

Architects play a critical role, working closely with developers and communities to create housing options that are affordable, healthy, and safe. The LIHTC program promotes innovative and cost-effective solutions and, in many cases, is essential to project feasibility. The competitive nature of the program necessitates deep partnerships between developers and architects, and a focus on community-building initiatives.

The program has a set annual limit on the amount of tax credits that can be allocated to developers in each state. This limit is referred to as the "cap." The cap is based on population and other factors, and it dictates how much tax credit can be distributed to affordable housing projects in a given year.

To help combat the affordable housing crisis and stimulate construction during challenging times the federal government temporarily increased the cap on LIHTC allocations by 12.5%. This increase meant that states received more tax credits, allowing them to fund more affordable housing projects.

The 12.5% increase expired in 2021. This means that the annual allocation of LIHTC reverted to the original, pre-increase cap.

CONGRESSIONAL ASK

- Reinstate the 12.5 percent increase in tax credits available for low-income housing that expired in 2021 and make it permanent.
- Increase the credits available to states by 50 percent for the next two years.
- Allow architectural firms to receive tax credits or grants when providing design services for affordable and workforce housing.
- Create a Federal Workforce Housing Tax Credit to address the needs of middle-income earners and create opportunities for sustainable housing developments.

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179D Energy Efficient Commericial Building Deduction

The Challenge

As energy efficiency becomes a critical focus for both public and private sectors, expanding the 179D deduction can drive broader adoption of sustainable design practices. Enhanced access for architectural firms, particularly those engaged in retrofits or government projects, will amplify the industry's impact on reducing energy consumption and greenhouse gas emissions.

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BACKGROUND

The 179D deduction incentivizes energy-efficient design in commercial buildings by offering tax savings for qualifying improvements to HVAC systems, lighting, and building envelopes. This deduction not only supports cost savings but also encourages innovation in energy-saving technologies. Established under the Energy Policy Act of 2005, this deduction encourages the adoption of energy-saving technologies and sustainable building practices. The Inflation Reduction Act of 2022 (IRA) introduced significant modifications to Section 179D, enhancing its applicability and benefits.

WHY PROTECT THE 179D DEDUCTION

Architectural firms play a crucial role in creating energy-efficient designs for government and commercial buildings. The 179D deduction provides direct benefits through:

- **Deductions for energy-efficient designs in government projects via allocation from property owners:** Government entities making energy-efficiency upgrades to public buildings can allocate the Section 179D deduction to designers of energy-efficient commercial building property.
- **Financial incentives for firms committed to sustainable and energy-efficient architecture:** The deduction serves as a financial incentive for firms dedicated to sustainable design, offsetting costs associated with implementing advanced energy-efficient systems.
- **Opportunities to increase project scope by consulting on retrofits and upgrades:** The IRA expanded Section 179D to include an alternative deduction for buildings engaged in qualified retrofit plans, allowing deductions based on the adjusted basis in the retrofitted property.

THE ASK

Congress should:

1. **Protect the 179D deduction amount** to encourage greater investment in energy-efficient building systems.
2. **Permit multiple deductions** for the same building when substantial additional upgrades are made over time.
3. **Extend eligibility** to architectural firms for consulting on retrofits and updates to existing buildings, including public and non-profit projects.
4. **Streamline the allocation process** for design firms working on government projects, ensuring smaller firms have equitable access to these deductions.

199A Pass Through Deduction

The Challenge

Income thresholds and phase-out rules under the current law can disadvantage architectural firms with higher revenues, especially those undertaking significant public or commercial projects. Expanding access and making the deduction permanent will provide firms with the financial certainty they need to plan for growth, innovation, and community contributions.

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BACKGROUND

Section 199A provides a 20% deduction on qualified business income (QBI) for pass-through entities, including partnerships, S corporations, and sole proprietorships. QBI includes the ordinary, non-investment income earned by a pass-through entity, such as business income after deducting expenses, for example wages, rent, and materials; income from domestic business operations (foreign income does not qualify), or a gain from the sale of business property, provided it is not a capital gain. This deduction was introduced under the Tax Cuts and Jobs Act to support small and medium-sized businesses by lowering their effective tax rate, fostering growth and competitiveness.

WHY RENEW THE PASS-THROUGH DEDUCTION

The 199A deduction is set to expire without congressional action. If not renewed, small and mid-sized architecture firms will face higher tax burdens, limiting their ability to invest in employees, new technology, and community-impact projects. Ensuring continued access to the deduction is essential for sustaining growth in the architectural sector.

Many architectural firms operate as pass-through entities, and this deduction can lower the effective tax rate on income to help small businesses stay competitive with larger corporations. Key benefits include:

- **Lower effective tax rates**, improving profitability for small and mid-sized firms.
- **Enhanced capacity to invest** in workforce development, innovation, and firm expansion.
- **Increased competitiveness** with larger corporations that may have access to other tax advantages.

THE ASK

Renew the expiring pass-through policy without changes, including the provision excluding architecture and engineering firms from the definition of "service" industries subject to income limitations that reduce the deduction for those types of businesses.

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Support Funding for Historic Preservation

The Challenge

The AIA supports governmental policies, programs, and incentives to preserve and rehabilitate diverse historic structures, sites, and places.

Increase the credit, lower the rehabilitation threshold, increase the value of the credit by eliminating value deductions, and extend eligibility by simplifying the application process.

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BACKGROUND

The federal historic rehabilitation tax credit (HTC) program finances the rehabilitation of historic buildings with a 20 percent tax credit for qualified expenditures. This program has been the most significant and successful investment made toward the preservation of historic buildings.

WHY UPDATES TO THE HISTORIC TAX CREDIT ARE NEEDED

The benefits of historic rehab go far beyond one building—historic tax credit projects spur an increase in property values, draw new businesses, attract new residents, and enlarge the tax base. The program revitalizes communities and spurs economic growth—all while returning more to the Treasury than it costs, $1.20 in tax revenue for every dollar invested. For architectural firms specializing in historic preservation or adaptive reuse projects, the HTC provides a critical incentive for clients to engage in these projects, expanding business opportunities in this specialized area. This credit is vitally important to main streets across the country and preserves the cultural and community significance of cities large and small.

THE ASK

In the next tax bill, Congress should:

- Increase the credit from 20% for projects with less than $2.5 million in qualified rehabilitation expenses, making it easier to complete small rehabilitation projects.
- Lower the substantial rehabilitation threshold, making more buildings eligible to use the credit.
- Eliminate the requirement that the value must be deducted from a building's value, which will increase the value of the credit and make it easier to pair with the federal Low Income Housing Tax Credit.
- Extend eligibility for credits to smaller architectural firms by simplifying the application and compliance process. Additionally, allow firms involved in the initial design phases of historic restoration projects to claim a portion of the credit encouraging firms to take on complex preservation work.