



# Coordinated Issue Data Processing Industry Wages of Technical Writers and the R & E Credit (Revised: February, 1, 1996)

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## **ISSUE**

Whether the wages paid for the preparation of user manuals to technical writers, editors, illustrators and others (hereinafter referred to as writers) constitute a "qualified research expense" for purposes of computing the research credit under section 41.

## **CONCLUSION**

Wages paid to writers who assist in the preparation of user manuals do not constitute a "qualified research expense" for purposes of computing the research credit under section 41.

## **FACTS**

Taxpayers in the data processing industry (and other industries) employ writers to prepare and update documents that are used by the sales division to explain to its customers, and other interested parties, how to operate the equipment and software they sell or lease. The writers are expected to prepare clear, accurate, well organized documentation in accordance with department standards on products developed by the company. The ultimate goal of this documentation is to produce a user manual to be associated with the product to instruct a user in the operation of the product. Examples of tasks performed by these individuals in accordance with their job descriptions are:

1. interviewing engineers to obtain information about projects;
2. developing outlines in accordance with department standards;
3. helping plan revisions of existing documents;
4. making revisions according to plans;
5. defining the appropriate audience, and targeting documentation to that audience;
6. providing preliminary versions of artwork;
7. working with the editorial and production staffs;
8. working with the other writers to establish the scope of and the schedules for projects;
9. maintaining familiarity with and using hardware, software and human resources in the department;
10. assisting other writers as requested by the lead writer;
11. assisting in the training of new hires;
12. interviewing job candidates; and
13. participating in setting department standards and procedures.

## **LAW AND ANALYSIS**

Section 41(a) provides a credit against tax for increasing research activities. The credit is an incremental credit equal to the sum of 20 percent of the excess of the taxpayer's qualified research expenses for the taxable year, over a base amount, and 20 percent of the taxpayer's basic research payments. Under section 41(b) qualified research expenses include in house expenses for wages paid and supplies used in the conduct of qualified research, and 65 percent of any contract expenses for qualified research.

For taxable years beginning after December 31, 1985 the definition of qualified research contained in section 41(d) provides four tests for determining whether product development activities constitute qualified research. The activity must satisfy all four tests in order to qualify.

The first test is found in section 41(d)(1)(A), which provides that an activity constitutes qualified research only if the cost of that activity may be deducted under section 174. Thus, the cost of the activity must qualify as a research or experimental expenditure as defined in section 1.174-2(a).

The second test is found in section 41(d)(1)(B)(i), which provides that in order to meet the definition of qualified research an activity must be undertaken for the purpose of discovering information "which is technological in nature." The Conference Report to the Tax Reform Act of 1986 (the 1986 Act) describes this technological test.

Section 41(d)(1)(B)(ii) provides the third test, which requires that the application of the technological information (discussed above) be "intended to be useful in the development of a new or improved business component of the taxpayer ... ." Thus, qualified research only includes activities related to the development of new or improved business components, and does not include activities for producing a finished product.

The fourth test, found in Section 41(d)(1)(C), requires that substantially all the activities related to a research effort constitute elements of a process of experimentation for the purposes described in section 41(d)(3) in order for the research to be qualified research. The Conference Report to the 1986 Act provides the description of this process of experimentation test.

Section 41(b)(1) defines "qualified research expense" as the sum of the in-house research expenses and contract research expenses paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer. Section 41(b)(2)(A)(i) defines in-house research expenses, in part, as any wages paid or incurred to an employee of the taxpayer for qualified services performed by such employee. Section 41(b)(2)(B) states that "qualified services" means services consisting of: (i) engaging in qualified research, or (ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

Section 1.41-2(c)(1) of the Income Tax Regulations states that the term "engaging in qualified research" as used in section 41(b)(2)(B) means the actual conduct of qualified research (as in the case of a scientist conducting laboratory experiments). Section 1.41-2(c)(2) states the term "direct supervision" as used in section 41(b)(2)(B) means the immediate supervision (first-line management) of qualified research (as in the case of a research scientist who directly supervises laboratory experiments, but who may not actually perform experiments). "Direct supervision" does not include supervision by a higher-level manager to whom first-line managers report, even if that manager is a qualified research scientist. "Direct supervision" also does not include supervision of employees who merely support qualified research activities.

Section 1.41-2(c)(3) of the Income Tax Regulations states the term "direct support" as used in section 41(b)(2)(B) means services in the direct support of either: (i) persons engaging in actual conduct of qualified research, or (ii) persons who are directly supervising persons engaging in the actual conduct of qualified research. Direct support of research activities does not include general administrative services, or other services only indirectly of benefit to research activities. This is true whether general administrative personnel are part of the research department or in a separate department. Direct support does not include supervision. Supervisory services constitute "qualified services" only to the extent provided in section 1.41-2(c)(2).

Section 1.41-2(d)(1) of the Income Tax Regulations states wages paid to or incurred for an employee constitute in-house research expenses only to the extent the wages were paid or incurred for qualified services performed by the employee. If an employee has performed both qualified services and nonqualified services, only the amount of wages allocated to the performance of qualified services constitutes an in-house research expense. In the absence of another method of allocation that the taxpayer can demonstrate to be more appropriate, the amount of in-house research expense shall be determined by multiplying the total amount of wages paid to or incurred for the employee

during the taxable year by the ratio of the total time actually spent by the employee in the performance of qualified services for the taxpayer to the total time spent by the employee in the performance of all services for the taxpayer during the taxable year.

A technical or manual writer is the link between the engineers who design, develop and build a product and the marketing people who are responsible for distributing and selling the finished product. It is the writer who interviews the engineers to understand the concept of the product and prepares the manuals and other documentation that are necessary to market the product. Writers are not responsible for developing a new product, service, process, or technique. In fact, for the most part, the research or experimental work related to taxpayer's products has largely been completed before the wage expense of the writers related to the preparation of manuals has been incurred. In short, writers do not discover technological information. They convey whatever previously discovered technological information is needed to be understood by the product's consumers through instructional and explanatory documents to facilitate the product's use by customers.

Such user manuals address the functions and manipulations of the product available to the lay user in simple, ordinary language rather than technical language. The technical ways the product achieves these functions are almost always not revealed or discussed in the manuals at all. In most cases, the technological information discovered during the development of the product remains invisible or transparent to both the product users and the technical writers. It is most often not necessary to understand such technical information in order to successfully use the product or to write the manuals for the product. Thus most technological discoveries necessary for a product's development have no bearing on the writer's user manual preparation.

Technical writers are hired primarily for their communication aptitudes and writing abilities – to apply those abilities to the production of user manuals. In the process of the development of these manuals, some technical understanding or mastery of the product must be achieved by the writers. Such mastery has been termed by some a part of the process of product testing, and thus a part of the research experimentation process. However, such testing is not performed to improve or perfect the product but rather to help the writers understand the product. Indeed the writers do not have the technical ability to improve the product themselves, should they find any problems in their use of the product. Other independent testers are utilized to serve as the principle consumer testers, and that is their only function. Since such testers are not primarily burdened with a responsibility to fully understand the product in order to explain its functions to others in a written form, they perform their product testing in a more natural consumer psychological environment. If the technical writers early use of the product served as an effective user test, no independent consumer testing would be needed. This is simply not the case as industry has found in developing its testing practices. Thus any product testing done by the writers is merely incidental to their primary purpose of producing user manuals.

None of the primary or major tasks provided in the job descriptions of the writers related to the preparation of manuals is a task that would satisfy the definition of qualified research under section 1.41 2(c). The process of preparing the manuals by the writers do not require the application of any natural, physical, or laboratory sciences to discover information. Nor do they require the application of engineering principles or the principles of computer science to discover information. Their work does not result in any technological breakthrough, but rather comes after such breakthroughs. The writers' jobs do not give the writers any supervisory authority over the engineers, etc., who are engaged in qualified research. Therefore, the writers' services do not constitute direct supervision. Because the writers may only provide a minor, incidental testing service (as part of their primary writing function) for the engineers, etc., who are conducting the research activities, the writers cannot be considered to be directly supporting those employees engaged in qualified research.

The primary function of the writer is to prepare manuals explaining the operation of various hardware and software products. These manuals are not used in the conduct of qualified research, but are used in marketing the products, and are enclosed with the finished product for use by customers. Because the services performed by writers do not constitute qualified services within the meaning of section 41(b)(2)(B), the wages paid to them do not meet the requirements of qualified research

expenses.

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