

CR 12-015

ORDER OF THE DEPARTMENT OF REVENUE CREATING RULES

The Wisconsin Department of Revenue adopts an order to: **create** Tax 11.20; **relating to** sales and use tax exemptions for biotechnology.

The scope statement for this rule, SS 040-11, was approved by the Governor on November 14, 2011, published in Register No. 671 on November 30, 2011, and approved by the Secretary of Revenue on December 12, 2011.

Analysis by the Department of Revenue

Statutes interpreted: s. 77.54(57), Stats.

Statutory authority: ss. 77.54(57)(a)1m. and 227.11(2)(a), Stats.

Explanation of agency authority: Section 77.54(57)(a)1m., Stats., provides authority for the department to certify, in the manner prescribed by the department, a business as a biotechnology business.

Section 227.11(2)(a), Stats., provides “[e]ach agency may promulgate rules interpreting the provisions of any statute enforced or administered by the agency, if the agency considers it necessary to effectuate the purpose of the statute...”

Related statute or rule: There are no other applicable statutes or rules.

Plain language analysis: The rule includes guidance for the sales and use tax exemptions for property and items used in qualified research and raising animals used in qualified research or manufacturing, criteria used by the department to certify a business as a biotechnology business, definitions applicable to the exemptions, clarification that "engaged primarily in manufacturing or biotechnology in this state" means more than 50% of a person's activity in Wisconsin is manufacturing or biotechnology, and examples to clarify the treatment of certain items under the exemptions.

Summary of, and comparison with, existing or proposed federal regulation:

There is no existing or proposed federal regulation that is intended to address the activities to be regulated by the rule.

Comparison with rules in adjacent states: The department is not aware of a similar rule in an adjacent state.

Summary of factual data and analytical methodologies: The department has created this rule order to comply with the statutory requirement to prescribe the manner in which a business will be certified for the sales and use tax exemptions for biotechnology under s. 77.54(57), Stats. No other data was used in the preparation of this rule order or this analysis.

Analysis and supporting documents used to determine effect on small business: As explained above, this rule is created to administer Wisconsin's sales and use tax laws. The rule itself does not have an effect beyond the statutes it interprets. As such, the department has determined that the rule does not affect small businesses.

Anticipated costs incurred by private sector: This rule does not have a fiscal effect on the private sector.

Effect on small business: This rule does not affect small business.

Agency contact person: Please contact Dale Kleven at (608) 266-8253 or dale.kleven@revenue.wi.gov, if you have any questions regarding this rule.

SECTION 1. Tax 11.20 is created to read:

Tax 11.20 Property used in qualified research and property used to raise research animals. (1) DEFINITIONS. In this section:

(a) "Animals" include bacteria, viruses, and other microorganisms.

(b) "Biotechnology" means the application of biotechnologies, including recombinant deoxyribonucleic acid techniques, biochemistry, molecular and cellular biology, genetics, genetic engineering, biological cell fusion, and other bioprocesses, that use living organisms or parts of an organism to produce or modify products to improve plants or animals or improve animal health, develop microorganisms for specific uses, identify targets for small molecule pharmaceutical development, or transform biological systems into useful processes and products.

(c) "Biotechnology business" means a business certified, as described in sub. (4), by the department to be primarily engaged in the application of biotechnologies that use a living organism or parts of an organism to produce or modify products to improve plants or animals, develop microorganisms for specific uses, identify targets for small molecule pharmaceutical development, or transform biological systems into useful processes and products.

(d) "Institution of higher education" means an accredited educational organization providing education after completion of high school, including undergraduate, graduate, and professional education.

(e) "Machinery" has the meaning given in s. 70.11 (27) (a) 2., Stats., and means a structure or assemblage of parts that transmits forces, motion or energy from one part to another in a predetermined way by electrical, mechanical or chemical means, but "machinery" does not include a building.

(f) "Person" includes any natural person, firm, partnership, limited liability company, joint venture, joint stock company, association, public or private corporation, the United States, the state, including any unit or division of the state, any county, city, village, town, municipal utility, municipal power district or other governmental unit, cooperative, unincorporated cooperative association, estate, trust, receiver, personal representative, any other fiduciary, any other legal entity, and any representative appointed by order of any court or otherwise acting on behalf of others.

(g) "Primarily" means more than 50 percent.

(h) "Qualified research" means qualified research as defined under section 41 (d) (1) of the Internal Revenue Code.

(i) "Used exclusively" means used to the exclusion of all other uses except for other use not exceeding 5% of total use.

(2) EXEMPTIONS FOR PROPERTY AND ITEMS USED IN QUALIFIED RESEARCH. (a) Sales of the following property and items to a person who is engaged primarily in manufacturing or biotechnology in Wisconsin are exempt:

1. Machinery and equipment, including attachments, parts, and accessories, that are used exclusively and directly in qualified research.

2. Tangible personal property or an item or property under s. 77.52 (1) (b) or (c), Stats., that is consumed or destroyed or loses its identity while being used exclusively and directly in qualified research, including fuel and electricity that is used exclusively and directly in qualified research.

(b) For purposes of determining whether a person is engaged primarily in manufacturing or biotechnology in this state under par. (a), only activities in Wisconsin are considered. When a person conducts activities in Wisconsin in addition to manufacturing or biotechnology, the person must allocate its activities between its manufacturing and biotechnology activities and its other activities using a reasonable and consistent method. If a person's manufacturing and biotechnology activities in Wisconsin are more than 50% of its total activities in Wisconsin, the person is engaged primarily in manufacturing or biotechnology in this state.

(Example 1) Company A performs research and development services at locations in Wisconsin for its customers. This is Company A's only activity in Wisconsin. Some of the research and development services are biotechnology and some of the research and development services are not biotechnology. Using the sales price of its services as the measure of activity, more than 50% of the total sales price Company A receives for performing all of its research and development services in Wisconsin is derived from biotechnology. Therefore, Company A is primarily engaged in biotechnology in Wisconsin.

(Example 2) Company B performs research and development services at locations outside of Wisconsin. Company B manufactures tangible personal property at a location in Wisconsin. This is Company B's only activity in Wisconsin. The products manufactured in Wisconsin are used by Company B in performing its research and development services at locations outside of Wisconsin. Company B is engaged primarily in manufacturing in Wisconsin since manufacturing is its only activity in Wisconsin.

(Example 3) Company X manufactures machinery at a plant outside of Wisconsin. Company X operates a facility in Wisconsin that is devoted solely to research and development relating to the products Company X manufactures. Although Company X's activities in Wisconsin are research and development activities that constitute qualified research, its activities in Wisconsin are not biotechnology. The research and development activities are Company X's only activities in Wisconsin. Therefore, Company X is not engaged primarily in manufacturing or biotechnology in Wisconsin.

(Example 4) Company Z manufactures products at a plant outside of Wisconsin. Company Z operates a facility in Wisconsin that is devoted solely to research and development. This is Company Z's only activity in Wisconsin. The research and development relates to products Company Z currently manufactures as well as to new products that Company Z may manufacture. Some of its research and development

activities in Wisconsin constitute biotechnology and qualified research. Since Company Z only performs research and development activities for itself, it does not have any sales revenue from these activities. Company Z reasonably allocates its costs and expenses incurred in conducting all of these research and development activities in Wisconsin between biotechnology and non-biotechnology. More than 50% of these costs and expenses are for biotechnology. Therefore, Company Z is engaged primarily in biotechnology in Wisconsin.

(Example 5) Company T is a new business located solely in Wisconsin. In its first year of operation, Company T's only activity is developing new products for itself. Some of these development activities are biotechnology. Since Company T only performs development activities for itself, it will not have any sales revenues during its first year of operations. Company T reasonably allocates its costs and expenses incurred in conducting all of its development activities in Wisconsin between biotechnology and non-biotechnology during its first year of operations. More than 50% of these costs and expenses are for biotechnology. Therefore, Company T is engaged primarily in biotechnology in Wisconsin.

(c) For purposes of determining whether an activity is qualified research under par. (a) 1. or 2., the regulations under Treas. Reg. section 1.41-4 apply.

(Note) Treas. Reg. section 1.41-4 provides interpretation and guidance concerning what constitutes qualified research under section 41 (d) (1) of the Internal Revenue Code. Treas. Reg. section 1.41-4 is available at www.gpoaccess.gov.

(d) If property or an item purchased without tax by claiming an exemption under par. (a) is used for non-exempt purposes that exceed 5% of total use, that property or item is subject to sales or use tax.

(Example 1) Company A is engaged primarily in manufacturing in Wisconsin. Company A purchases a machine that it will use directly in conducting qualified research at its manufacturing plant in Wisconsin and purchases it exempt from Wisconsin sales tax claiming the exemption in par. (a). After completing the qualified research and having made no use of the machine other than direct use in qualified research, Company A begins using the machine exclusively and directly in its manufacturing operation, which is another exempt use. Company A does not owe Wisconsin sales or use tax on its purchase of the machine since it only used the machine in an exempt manner.

(Example 2) Company B is engaged primarily in manufacturing in Wisconsin. Company B purchases a machine that it will use directly in conducting qualified research at its manufacturing plant in Wisconsin. More than 5% of Company B's total use of this machine will be for conducting research and development projects that do not meet the definition of qualified research. Company B's purchase of the machine is taxable because it is not used exclusively in qualified research.

(Example 3) Company C is engaged primarily in manufacturing in Wisconsin. Company C develops a new product in an activity that is qualified research. Company C purchases a variety of raw materials. Some of these materials are used exclusively and directly and destroyed in qualified research. Once the qualified research is completed, Company C consumes the remaining raw materials in activities that are not qualified research. Company C's purchases of the raw materials that it uses exclusively and directly and destroys in qualified research are exempt under par. (a) 2. Company C's purchases of the raw materials that it uses in activities that are not qualified research do not qualify for this exemption.

(Example 4) Manufacturer P is engaged primarily in manufacturing in Wisconsin. Manufacturer P contracts with Company D to produce a prototype that is tangible personal property. Manufacturer P's primary objective in this transaction is to obtain the prototype, rather than a research and development service. Company D may purchase the materials used to construct the prototype without tax for resale. Manufacturer P will use the prototype exclusively and directly in one of its research and development activities that constitutes qualified research and may claim the exemption under par. (a) on its purchase of the prototype.

(Example 5) Manufacturer F is engaged primarily in manufacturing in Wisconsin. Manufacturer F contracts with Company E to perform research services. Company E will provide a prototype that is tangible personal property to Manufacturer F along with these services. Manufacturer F's primary objective in this transaction is to obtain the research and development services. Company E's primary activity in Wisconsin is the provision of professional engineering services that do not involve biotechnology. Company E may not claim the exemptions under par. (a), since Company E is not engaged primarily in manufacturing or biotechnology in Wisconsin. In addition, Company E cannot purchase the materials without tax for resale that it uses to construct the prototype, because Company E uses the prototype in performing its research services. The prototype is transferred to Manufacturer F incidental to the research services.

(e) 1. A business claiming an exemption under par. (a) shall maintain records to substantiate that at least 95% of the property or item's total use is direct use in qualified research, including records to establish all of the following:

- a. The activity or activities in which the property or item is used.
- b. The manner in which the property or item is used in each activity.
- c. The activity or activities in which the property or item is used constitute qualified research.

2. If contemporaneous with the research activity or activities performed, documents that may, as required under subd. 1. c., establish an activity or activities that constitute qualified research include the following:

- a. Materials explaining the research activities conducted, including brochures, pamphlets, press releases, and other similar documents.
- b. Submissions to management, the board of directors, review committees, or other similar groups regarding the research projects, activities, and the expenditures.
- c. Documents prepared by, or on behalf of, internal audit, including quarterly and annual reports that refer in any manner to the research activities.
- d. Minutes, notes, or other similar recordings from budget, board of director, managerial or other similar meetings concerning the research activities.
- e. Project authorizations, budgets, or work orders that initiate a research project.
- f. Position and department descriptions of employees identified as providing qualified research.
- g. The internal authorization policies for approving a research project.

- h. Patent applications.
- i. Project summaries and/or project reports and project meeting minutes.
- j. Prototype and process testing reports, field and lab verification data/summary data.
- k. Papers, treaties, or other published documents regarding the taxpayer's research.
- L. Complete copies of contracts, including all modifications, letter agreements, memoranda of understanding, or similar documents for research performed by, or on behalf of, a third party.

(Example) This example illustrates records that are generally acceptable as adequate to document the exemptions under par. (a).

Company A is primarily engaged in manufacturing in Wisconsin. Company A attempts to make a new and improved widget. Upon approval of a project, Company A documents the scope and goals of the project, the uncertainties that exist in accomplishing these goals, and the processes by which Company A hopes to eliminate the uncertainties. In addition, contemporaneously with conducting the research project, Company A documents: (1) the location or locations at which the research is conducted, (2) the machinery and equipment used in the project and the manner used, (3) the various materials and supplies used in attempting to produce the improved widget, the purpose and manner in which such items were used, (4) the processes applied, (5) the results achieved throughout the research process, and (6) the point at which Company A either abandons the research project or achieves the goal of eliminating the uncertainties involved with the development of the new widget. Company A purchased various machinery and equipment, and supplies and materials used in conjunction with development of the new widget without tax claiming the purchases are exempt under par. (a). In general, contemporaneous records kept in the manner and detail described will be accepted and used by the department in making its determinations regarding whether the taxpayer is entitled to claim the exemptions under par. (a).

3. A business claiming an exemption under par. (a) shall provide records described in subd. 2. or any other information as required by the department to verify that activities are qualified research or that machinery, equipment, or other property or items are used exclusively and directly in qualified research.

(3) EXEMPTIONS FOR RAISING ANIMALS USED IN QUALIFIED RESEARCH OR MANUFACTURING. (a) Sales of the following property and items to a person who is engaged in the business of raising animals are exempt if all of the animals raised by the seller of the animals are sold primarily to biotechnology businesses, public or private institutions of higher education, and governmental units for exclusive and direct use by those entities in qualified research or manufacturing:

- 1. Machines and specific processing equipment, including accessories, attachments, and parts for the machines or equipment, that are used exclusively and directly in raising such animals.

2. Seeds for planting, plants, feed, fertilizer, soil conditioners, animal bedding, sprays, pesticides and fungicides, breeding and other livestock, poultry, farm work stock, baling twine and baling wire, containers for fruits, vegetables, grain, hay, silage and animal wastes, plastic bags, plastic sleeves and plastic sheeting used to store or cover hay or silage, medicines, semen for artificial insemination, fuel, and electricity, that are used exclusively and directly in raising such animals.

(Example 1) Company A raises various animals that it sells for use in qualified research. Company A sells more than 50% of the animals it raises to biotechnology businesses for exclusive and direct use in qualified research. All of the feed Company A purchases for exclusive and direct use in raising its animals is exempt.

(Example 2) Company T raises various animals that it sells for use in qualified research. Company T uses cages to raise some of these animals. Company T's purchases of cages are exempt only if more than 50% of all the animals raised by Company T are sold to biotechnology businesses, public or private institutions of higher education, and governmental units for exclusive and direct use by those organizations in qualified research or manufacturing.

(b) For purposes of determining whether an activity is qualified research under par. (a), the regulations under Treas. Reg. section 1.41-4 apply.

(Note) Treas. Reg. section 1.41-4 provides interpretation and guidance concerning what constitutes qualified research under section 41 (d) (1) of the Internal Revenue Code. Treas. Reg. section 1.41-4 is available at www.gpoaccess.gov.

(c) A person claiming an exemption under par. (a) shall obtain a "Purchaser's Statement to Seller for Animals Used in Qualified Research or Manufacturing," form S-209, from each of its customers described in par. (a) (intro.) and keep the completed forms as a part of its records to document the number of animals that were raised by the seller and sold to biotechnology businesses, public or private institutions of higher education, and governmental units for exclusive and direct use in qualified research or manufacturing. When completing Form S-209, the purchaser of the animals is attesting to the number of animals purchased and the number of animals used exclusively and directly in qualified research or manufacturing.

(Note) Form S-209 is available on the department's web site at www.revenue.wi.gov.

(4) CERTIFICATION OF BIOTECHNOLOGY BUSINESSES BY THE DEPARTMENT. (a) In order to be considered a biotechnology business for purposes of the exemptions under sub. (3), a business shall first obtain certification from the department.

(b) A business seeking certification or renewal of a certification under this subsection shall apply with the department in the manner prescribed by the department. The department may require any business submitting an application under this paragraph to provide additional information, as determined by the department, prior to the department granting or denying the applicant's request for certification or renewal of a certification.

(Note) Information concerning the certification process is available on the department's web site at www.revenue.wi.gov.

(Example) Additional information that may be requested by the department in processing an application includes documentation of the nature of the business' income and expenses.

(c) A business shall be certified by the department as a biotechnology business for the period described in par. (d) if, during that period, the business' activities are primarily biotechnology.

(d) The certification period under par. (c) shall correspond to the business' tax year as determined for federal income tax purposes, including short years, subject to the following conditions:

1. If a business is certified by the department with respect to a previous tax year, the certification is valid only for the previous tax year.

2. If a business is certified for a current tax year, the certification is valid until the expected end of the tax year unless, during such tax year the business' tax year terminates earlier than expected. When a tax year terminates earlier than expected, the certification is valid until the actual end of the tax year as determined for federal income tax purposes.

(e) Notwithstanding any other provision in this subsection, the department may:

1. Revoke any certification granted under this subsection, but only upon information that either the business' application for certification contained a misstatement as to the business' gross income or expenses and deductions or the business no longer qualifies as a biotechnology business.

2. Require any business seeking certification to be certified only with respect to its previous tax years.

SECTION 2. Effective date. This rule shall take effect on the first day of the month following publication in the Wisconsin Administrative Register as provided in s. 227.22 (2) (intro.), Stats.

Final Regulatory Flexibility Analysis

This rule order does not affect small businesses.

DEPARTMENT OF REVENUE

Dated: _____

By: _____
Richard G. Chandler
Secretary of Revenue

E:Rules/1107 Final Order