

SALES AND USE TAX EXEMPTION FOR QUALIFIED RESEARCH ON AND AFTER JULY 2, 2013

Fact Sheet 2101-2

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This fact sheet provides a general overview of sales and use tax exemptions for property purchased on and after July 2, 2013 and used in qualified research.

For information on the exemption for property used in qualified research and purchased from January 1, 2012 through July 1, 2013, see [Fact Sheet 2101-1: Sales and Use Tax Exemption for Qualified Research From January 1, 2012 Through July 1, 2013](#).

Additional information is provided in [Internal Revenue Code Regulation sec. 1.41-4](#), and [sec. Tax 11.20\(1\) and \(2\), Wis. Adm. Code](#) (August 2014 Register).

PROPERTY USED EXCLUSIVELY AND DIRECTLY IN QUALIFIED RESEARCH

Who may claim this exemption?

- Persons engaged in manufacturing in Wisconsin at a building assessed under sec. 70.995, Wis. Stats.
- Persons engaged primarily in biotechnology in Wisconsin.
- A combined group member who is conducting qualified research for another combined group member and that other combined group member is a person described above.

"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.

Note: Any "person" that is a single-owner entity that is disregarded as a separate entity for Wisconsin income or franchise tax purposes is disregarded as a separate entity for Wisconsin sales and use tax purposes.

"Building" means any structure that is intended to be a permanent accession to real property; that is designed or used for sheltering people, animals or plants, for storing property or for working, office, parking, sales or display space, regardless of any contribution that the structure makes to the production process in it; that in physical appearance is annexed to that real property; that is covered by a roof or encloses space; that is not readily moved or disassembled; and that is commonly known to be a building because of its appearance and because of the materials of which it is constructed.

"Combined group" means the group of all persons whose income and apportionment factors are required to be taken into account under sec. 71.255(2), Wis. Stats., to determine a member's share of the net business income or loss apportionable to Wisconsin that is attributable to a unitary business.

"Manufacturing" means the production by machinery of a new article of tangible personal property, or certain item or property, with a different form, use, and name from existing materials, by a process popularly regarded as manufacturing, and that begins with conveying raw materials and supplies from plant inventory to the place where work is performed in the same plant and ends with conveying finished units of tangible personal property, or certain items or property, to the point of first storage in the same plant. It does not include storing raw materials or finished units of tangible personal property or certain items or property, research and development, delivery to or from the plant, or repairing or maintaining plant facilities.

"Primarily" means more than 50%.

"Qualified research" means qualified research as defined under section 41(d) (1) of the Internal Revenue Code, except that it includes qualified research that is funded by a member of a combined group for another member of a combined group.

"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 plant 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.

"In Wisconsin" and "in this state" mean within the exterior limits of the state of Wisconsin.

What is exempt?

- Tangible personal property, including fuel and electricity, and certain other property consumed or destroyed or losing their identities while being used exclusively and directly in qualified research.
- Machinery and specific processing equipment, including attachments, parts, and accessories, used exclusively and directly in qualified research.

"Used exclusively" means at least 95% of the total use of the tangible personal property or certain other property must be direct use in qualified research or manufacturing.

Note: Machinery used directly in manufacturing part of the time (exempt use under sec. 77.54(6)(a), Wis. Stats.) and directly in qualified research the rest of the time (exempt use under sec. 77.54(57d), Wis. Stats.), qualifies for exemption.

Who is engaged primarily in biotechnology in Wisconsin?

A person is engaged primarily in biotechnology in Wisconsin when more than 50% of that person's activities in Wisconsin are biotechnology.

The primary activity is determined by a reasonable measure of activity for all activities conducted in Wisconsin. A reasonable measure of activity includes sales revenue, costs and expenses, or investment in plant, machinery and equipment.

Example (1): 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 relating to the products Company Z currently manufactures as well as to completely new products. This is Company Z's only activity in Wisconsin. Some, but not all, of its research and development activities in Wisconsin constitute biotechnology. 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 its research and development activities in Wisconsin between biotechnology and non-biotechnology. Based on these allocations, Company Z determines that more than 50% of these costs and expenses relate to the conduct of biotechnology.

Who is a combined group member conducting qualified research for another member of a combined group?

Any member of a combined group conducts qualified research for another member of the combined group when the research activity constitutes qualified research for that other member.

Example (2): Corporation A and Corporation B are members of a combined group for Wisconsin income/franchise tax purposes. Corporation B is conducting research under contract for Corporation A. Under IRC sec. 41(d)(1), the research activity is qualified research for Corporation A. For purposes of the sales and use tax exemption, Corporation B is a combined group member conducting qualified research for another member of a combined group.

What is qualified research?

"Qualified research" is defined in [sec. 41\(d\)\(1\)](#) of the Internal Revenue Code (IRC), includes qualified research funded by a member of a combined group for another member of a combined group, and means research:

- With respect to which expenditures may be treated as expenses under IRC sec. 174;
- Which is undertaken for the purpose of discovering information which is technological in nature;
- The application of which is intended to be useful in the development of a new or improved business component of the taxpayer; **and**
- Substantially all of the activities of which constitutes elements of a process of experimentation relating to a new or improved function, performance, reliability, or quality.

A person claiming exemption must establish that the research activity being performed meets ALL four of the above tests. These tests must be applied separately to each business component of the taxpayer. (In the case of funded research, the tests must be applied to each business component of the person funding the research.)

Example (3): For several years, T has manufactured and sold a particular kind of widget. T initiates a new research project to develop a new or improved widget.

T's activities to develop a new or improved widget are not excluded from the definition of qualified research. T's activities relating to the development of a new or improved widget constitute a new research project to develop a new business component. T's research activities relating to the development of the new or improved widget, a new business component, are not considered to be activities conducted after the beginning of commercial production.

Example (4): Corporation C and Corporation D are members of a combined group for Wisconsin income/franchise tax purposes. Corporation C is engaged in manufacturing in Wisconsin at a building assessed under sec. 70.995, Wis. Stats. Corporation C enters into a research contract with Corporation D. Corporation C is funding the research by Corporation D to attempt improve an existing product manufactured by Corporation C. The research constitutes qualified research under IRC sec. 41(d)(1) for Corporation C. For purposes of the sales and use tax exemption, Corporation D is conducting qualified research for another member of a combined group that is engaged in manufacturing at a building assessed under sec. 70.995, Wis. Stats.

What is NOT qualified research?

"Qualified research" does not include any of the following:

- Research not meeting the four tests described above
- Research that relates to style, taste, cosmetic, or seasonal design factors
- Research described in IRC sec. 41(d)(4) and IRC Regulation sec. 1.41-4(c), except that qualified research funded by a member of a combined group for another member of a combined group is "qualified research" for purposes of the sales and use tax exemption

Example (5): X is engaged in the business of manufacturing widgets at a building in Wisconsin assessed under sec. 70.995, Wis. Stats., and is a member of the same combined group for Wisconsin income/franchise tax purposes as Y. X wants to change the color of its blue widget to green. X contracts with Y to conduct research to determine a paint to use. Y obtains several different shades of green paint from various suppliers. Y paints several sample widgets, and surveys X's customers to determine which shade of green X's customers prefer.

X's activities to change the color of its blue widget to green are not "qualified research" because substantially all of X's activities are not a process of experimentation relating to a new or improved function, performance,

reliability, or quality. All of X's research activities are related to style, taste, cosmetic, or seasonal design factors. Since X is not conducting qualified research, Y's research activities being conducted for another member of a combined group are not qualified research for purposes of the sales and use tax exemption.

What about prototypes?

The following examples illustrate how the exemptions apply in the case of producing a prototype:

Example (6): Company Q contracts with Manufacturer S to design a machine that meets certain performance criteria. Company Q's primary purpose is to obtain the machine with its specific performance characteristics. Manufacturer S is engaged in manufacturing in Wisconsin at a building assessed under sec. 70.995, Wis. Stats. Manufacturer S develops several design concepts. Company Q selects a particular concept and enters into a contract with Manufacturer S for Manufacturer S to design and produce the machine. Manufacturer S retains the rights to the design of the machine and the information obtained during the research and development of the machine. The research and development activities conducted by Manufacturer S constitute qualified research. Once Manufacturer S has completed the qualified research, it produces the machine it will sell to Company Q by a process popularly regarded as manufacturing.

Manufacturer S purchases raw materials and component parts that become part of various prototypes it produces and tests while conducting the qualified research. To the extent these items are consumed, destroyed, or lose their identities while being used exclusively and directly in qualified research, the purchases are exempt under sec. 77.54(57d)(b)1., Wis. Stats. To the extent that any of these items are used both in qualified research and are an ingredient or component part of the final machine that is sold to Company Q, these purchases are exempt as property purchased for resale, as provided in sec. Tax 11.67(3)(c)2., Wis. Adm. Code. To the extent that additional raw materials or component parts are purchased and used during the manufacturing process and become ingredients or component parts of the machine as it is sold to Company Q, Manufacturer S may purchase such items exempt from tax under sec. 77.54(2), Wis. Stats.

Machinery and equipment that is used by Manufacturer S: (1) exclusively and directly in qualified research, (2) exclusively and directly in manufacturing, or (3) at least 95% of total use directly in qualified research and directly in manufacturing, are exempt under sec. 77.54(6)(a) or (57d)(b)1., or both.

How is this exemption claimed?

Complete [Form S-211](#), *Wisconsin Sales and Use Tax Exemption Certificate*, and provide it to the seller at the time of purchase.

What documentation must be kept?

A business claiming the exemption is required to maintain records adequate to substantiate that at least 95% of the property or item's total use is direct use in qualified research.

Documents ordinarily should be prepared and maintained at the time of the research **by business component** that detail:

- Project scope (including uncertainty being addressed and alternative methods for resolving uncertainty)
- Research and testing activities performed
- Results of the research (including evaluation of tests performed and summary of uncertainty resolved)
- The activity or activities in which the property or item is used.
- The manner in which the property or item is used in each activity.
- The activity or activities in which the property or item is used constitute qualified research.

Additional information on recordkeeping is provided in [sec. Tax 11.20\(2\)\(e\), Wis. Adm. Code](#) (August 2014 Register).

How are manufacturing and biotechnology different?

"Manufacturing" requires that a new article of tangible personal property with a different form, use, and name from existing materials, by a process popularly regarded as manufacturing be produced. "Manufacturing" itself does not include research and development activities.

"Biotechnology" can include research and development activities as well as manufacturing activities. For example, "biotechnology" as a research and development activity may include: (1) the development of microorganisms for specific uses, (2) identification of targets for small molecule pharmaceutical development, and (3) transforming biological systems into useful processes and products. "Biotechnology" as a manufacturing activity occurs when living organisms or parts of an organism are used to produce or modify products to improve plant or animals or improve animal health by a process that is "manufacturing."

How does the exemption compare to the Wisconsin income/franchise tax research credit?

Both the sales and use tax exemption and the research credit require:

- The activities be qualified research as defined in IRC sec. 41(d)(1), except that, for purposes of the sales tax exemption, it includes qualified research funded by a member of a combined group for another member of a combined group.
- Documentation to show an activity is "qualified research."

Differences between the Wisconsin sales and use tax exemption and the Wisconsin income/franchise tax research credit include:

- The research credit is available only for qualified research conducted in Wisconsin.
- The sales and use tax exemption is available to qualifying persons performing qualified research and applies to purchases used in qualified research conducted anywhere in the United States, the Commonwealth of Puerto Rico, and any other possession of the United States.
- For the income/franchise tax research credit, not all expenses incurred in activities that are qualified research necessarily result in an income/franchise tax research credit (e.g., due to base year computations). A sales and use tax exemption may still apply.
- Persons claiming the sales and use tax exemption must be engaged in the required manufacturing or biotechnology in Wisconsin or be a combined group member performing the qualified research for another combined group member who is engaged in the required manufacturing or biotechnology in Wisconsin. Persons qualifying for the income/franchise tax research credit may be engaged in other businesses.

ADDITIONAL INFORMATION

For more information and examples, refer to [sec. 77.54\(57d\), Wis. Stats.](#), and [Internal Revenue Code Regulation sec. 1.41-4](#), and [sec. Tax 11.20\(1\) and \(2\), Wis. Adm. Code](#) (August 2014 Register).

Questions regarding these sales and use tax exemptions may be directed to:

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