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SC PRIVATE LETTER RULING #93-6

TO: The University

TAX ANALYST: Deana West

SUBJECT: Research and Development Machinery
(Sales and Use Taxes)

DATE: September 8, 1993

REFERENCES: S.C. Code Ann. Section 12-36-2110 (Supp. 1992)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1992)
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request.

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Question:

Does the purchase of each item of a large computer system by the University qualify as research and development machinery subject to the \$300 maximum sales tax?

Facts:

The University (University) along with four national research laboratories and five other universities are members of the Partnership in Computational Sciences (PICS). The PICS project involves USC scientists and engineers working in collaboration with the other member institutions to develop basic engineering tools needed to clean up hazardous waste which threatens water supplies in the United States.

Research grants have been awarded over a five year period by the U.S. Department of Energy to support this work. The award includes funds to purchase a large computer system that will be located at one of the national research laboratories and smaller computers to be located at the member universities. The University has received a \$500,000 grant to aid in the purchase of an Intel Paragon XP/S Model A4 parallel supercomputer.

The University will use the computer, in part, for basic research conducted under the PICS program for the duration of the project. The computer will be used to develop highly sophisticated computer software that will aid scientists and engineers in determining how to clean up groundwater contamination. Computer time not committed to the PICS effort will be devoted to research and development in the field of chemistry, mathematics, engineering and geology that will aid in the development of software and other research and development products. The University researchers will access the computer via the campus network. Access to the machine by other researchers will be via a contributed statewide network owned by the SCANA Corporation.

The University High Performance Computing Advisory Committee will determine other research projects which will be allowed access to the computer. The University will ensure that all users will comply with the research and development restrictions set forth in Code Section 12-36-2110.

The computer will not be used for efficiency surveys, management studies, humanities research, economic studies, management science/operations research, consumer surveys, advertising and promotion activities, or research in connection with literary, historical, or similar projects.

The physical location of the computer will be in a portion of the second floor of the University Computer Services Division building. This location currently houses a large scale parallel processor that is devoted to research and development of computer software by the computer science and mathematics departments. Entrances to the facility are limited by keyless entry system which restricts access only to approved researchers.

The computer will have its own dedicated staff person who will not be integrated with the other staff of the University Computer Services Division. This person will be responsible for maintenance, operation and upkeep of the computer.

Discussion:

Code Section 12-36-910(A) imposes a sales tax and reads, in part:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

Code Section 12-36-1310(A) imposes a use tax and reads, in part:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this state.

Code Section 12-36-2110 imposes a maximum tax on the sale of certain items and reads, in part:

(D) The maximum tax levied pursuant to this chapter on the sale or use of each item of machinery for research and development is three hundred dollars. As used in this subsection, “machinery for research and development” means machinery used directly and exclusively in research and development in the experimental or laboratory sense for new products, new uses for existing products, or for improving existing products. To be eligible for the limitation imposed by this subsection, the machinery must be located in a separate facility devoted exclusively to research and development as defined in this subsection. The limitation does not extend to machinery used in connection with efficiency surveys, management studies, consumer surveys, economic surveys, advertising, promotion, or research in connection with literary, historical, or similar projects.

Therefore, for the 5% state sales or use tax to apply there must be a retail sale or retail purchase of tangible personal property. As provided in code Section 12-36-2110, certain items including each item of research and development machinery are subject to the \$300 maximum tax.

In order to qualify for the maximum tax on research and development machinery, two requirements must be met:

1. The property must be used directly and exclusively in research and development, and
2. The property must be located in a separate facility devoted exclusively to research and development.

The first requirement concerns the use of the computer. Machinery for research and development is defined in the statute as “machinery used directly and exclusively in research and development in the experimental or laboratory sense for new products, new uses for existing products, or for improving existing products”.

The last sentence in the statute specifies what research and development equipment is not. Specifically, the \$300 sales tax limitation does not apply to machinery used in connection with efficiency surveys, management studies, consumer surveys, economic surveys, advertising, promotion, or research in connection with literary, historical, or similar projects.

As discussed in the facts, the computer will be used half of the time to develop highly sophisticated computer software that will aid scientists and engineers in determining how to clean up groundwater contamination. Computer time not committed to the PICS effort will be devoted to research and development in the field of chemistry, mathematics, engineering and geology that will aid in the development of software and other research and development products. The computer will not be used for efficiency surveys, management studies, humanities research, economic studies, management science/operations research, consumer surveys, advertising and promotion activities, or research in connection with literary, historical, or similar projects. The University will ensure that all users will comply with the research and development restrictions set forth in Code Section 12-36-2110.

Based upon the facts presented, the computer is being used as research and development machinery as defined in the statute.

The second requirement to be addressed concerns the location of the machinery. Commission Decision #92-61 addressed this issue. In this decision, the Commission determined that the research and development function constituted a separate facility devoted exclusively to research and development. This conclusion was reached based on the following facts: (1) the research and development function was secluded, set apart and kept apart from other functions, (2) it is installed to serve a particular distinct purpose, (3) it is autonomous with its own director and separate management and specific employees, (4) its space is separated from other functions, and (5) it is accounted for separately and is treated as a separate operating entity by management.

With respect to the physical location of the machinery, The University has indicated: (1) the computer will be located in a separate facility of the University Computer Services Division building, (2) this facility already contains a large scale parallel processor that is devoted to research and development of computer software by the computer science and mathematics departments and meets the requirements in Code Section 12-36-2110, (3) the computer is being purchased to develop software for the PICS project and software and other products for the research and development projects not dedicated to the PICS project, (4) entrances to the facility are limited by a keyless entry system by approved researchers, and (5) the computer will have its own dedicated staff person who will not be integrated with the other staff of the University Computer Services Division.

Based upon the facts presented, the new large computer system is located in a separate facility devoted exclusively to research and development.

Conclusion:

Based upon the facts presented by the University, the large computer system purchased will be used exclusively to develop computer software and other research and development products. It meets all of the requirements in Code Section 12-36-2110 to qualify as research and development machinery. Accordingly, each item of the computer system qualifies for the \$300.00 maximum tax.