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SC TECHNICAL ADVICE MEMORANDUM #89-21

TO: Mr. James L. Brodie, Director
Property Division

FROM: John Swearingen, Manager
Tax Policy and Procedures Department

DATE: June 27, 1989

SUBJECT: Classification and Valuation of Manufacturer's
Research & Development Equipment (Property Tax)

REFERENCE: S.C. Code Ann. Section 12-37-930 (Law. Co-Op. Supp. 1988)
S.C. Code Ann. Section 12-43-220(a) (Law. Co-Op. Supp. 1988)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Technical Advice Memorandum is a temporary document issued to an individual within the commission, upon request, and it applies only to the specific facts or circumstances related in the request. Technical Advice Memoranda have no precedential value and are not intended for general distribution.

Question:

1. What is the proper method of classification and valuation of a manufacturer's research and development (R & D) equipment?
2. Should the R & D equipment of a manufacturer be returned to the Commission on form P.T. 100 as business personal property or form P.T. 300 as manufacturer's machinery and equipment?

Facts:

ABC is a manufacturer with a research and development facility located in South Carolina. The county assessed this facility from the 1960's through the 1986 property tax year. The Commission began assessing this property for the 1987 property tax year. The county had assessed the R & D equipment as personal property under county jurisdiction. Under

Commission jurisdiction, R & D equipment purchased before July 1, 1986 was filed by the taxpayer as business personal property on form P.T. 100 while R & D equipment purchased after July 1, 1986 was filed by the taxpayer on form P.T. 300.

Law:

Section 12-43-220 which defines the classes of property for property tax purposes provides in part:

Except as otherwise provided, the ratio of assessment to value of property in each class shall be equal and uniform throughout the State. All property presently subject to ad valorem taxation shall be classified and assessed as follows:

- (a) All real and personal property owned by or leased to manufacturers and utilities and used by the manufacturer or utility in the conduct of the business must be taxed on an assessment equal to ten and one-half percent of the fair market value of the property.

Real property owned by or leased to a manufacturer and used primarily for research and development is not considered used by a manufacturer in the conduct of the business of the manufacturer for purposes of classification of property under item

- (a) of this section. The term "research and development" means basic and applied research in the sciences and engineering and the design and development of prototypes and processes.
- (e) All other real property not herein provided for shall be taxed on an assessment equal to six percent of the fair market value of such property.
- (f) Except as specifically provided by law all other personal property shall be taxed on an assessment of ten and one-half percent of fair market value of such property...

Section 12-37-930 which defines values of property for property tax purposes provides:

All property shall be valued for taxation at its true value in money which in all cases shall be held to be the price which the property would bring following reasonable exposure to the market, where both the seller and the buyer are willing, are not acting under compulsion, and are reasonably well informed as to the uses and purposes for which it is adapted and for which it is capable of being used...

...Provided, further, fair market value of manufacturer's machinery and equipment used in the conduct of the manufacturing business, excluding, however, vehicles licensed by the Highway Department, boats and airplanes shall be determined by reducing the original cost by an annual allowance for depreciation as stated in the following schedule.

Section 12-37-970 which provides for the assessment and return of property to the Commission states:

Notwithstanding any other provision of law, the assessment for property taxation of merchants' inventories, equipment, furniture and fixtures, and manufacturers' real and tangible personal property, and the machinery, equipment, furniture and fixtures of all other taxpayers required to file returns with the South Carolina Tax Commission for purposes of assessment for property taxation, shall be determined by the Commission from property tax returns submitted by the taxpayers to the Commission on or before the fifteenth day of the fourth month after the close of the accounting period regularly employed by the taxpayer for income tax purposes in accordance with Chapter 7, Title 12. The Commission by regulation shall prescribe the form of return required by this section, the information to be contained in it, and the manner in which the returns must be submitted.

Regulation 117-110 provides the following method to value furniture, fixtures and equipment of merchants and related businesses:

Section I. The fair market value of merchants' furniture, fixtures and equipment shall be the depreciated value as shown by the merchants' records for income tax purposes, provided however, that in no event is the original cost of the property to be reduced by more than ninety percent of the original capitalized cost.

Section II. This Regulation shall be effective for the 1975 tax year.

Discussion:

Section 12-43-220(a) establishes a class of real and personal property used in the conduct of a manufacturer's business to be taxed based on a 10.5% assessment ratio. Certain real property of a manufacturer such as R & D real property, is specifically classified as not being used in the conduct of a manufacturer's business. By virtue of being excluded, the R & D real property of a manufacturer is taxed based on an assessment ratio of 6% provided in Section 12-43-220(e). Whether R & D equipment of a manufacturer is classified as used in the manufacturer's business or not, the assessment ratio would be 10.5%. Section 12-43-220(a) provides a 10.5% assessment ratio for personal property used in a manufacturer's business and 12-43-220(e) provides a 10.5% assessment ratio for all personal property not given a specific assessment ratio. Thus, it is unclear what classification a manufacturer's R & D equipment was intended to receive for assessment ratio purposes.

Section 12-37-930 provides methods for determining value of property. The fair market value of a manufacturer's machinery and equipment used in the conduct of the manufacturing business is determined by reducing the original cost by an annual allowance for depreciation provided in the statute. The machinery and equipment cannot be depreciated below 20% of the original cost.

Generally, all property of a manufacturer is considered to be used in the conduct of a manufacturing business unless specified by statute or regulation. In an opinion relating to the research facility and office building of a manufacturer, the Attorney General's office concluded

that the facility and building were used in the conduct of a manufacturer's business. 1975-76 Op. Atty. Gen. No. 4548 p.418. This opinion related to the classification of the property for purposes of assessment ratios found in Section 12-43-220. Section 12-43-220 was amended in 1984 to provide that real property owned by or leased to a manufacturer and used primarily for research and development is not considered used in the conduct of the business of the manufacturer. Office buildings not located on the plant site were also classified as not being used in the conduct of the business of the manufacturer.

Administratively, the Commission assessed the property of a manufacturer used in the conduct of the business of the manufacturer and the counties assessed property not used in the conduct of the business of the manufacturer. This generally meant that the plant, machinery and equipment and offices contiguous to the plant were returned to the Commission on the P.T. 300. If the office building or research facility was not on the plant site it was returned to the county or if returned to the Commission the real estate was returned in a P.T. 300 and the equipment on a P.T. 100.

It appears, based on the fact that 12-43-220 classified the R & D real property as not being used in the conduct of the business of a manufacturer, that the R & D equipment should likewise be classified as not being used in the conduct of the business of a manufacturer.

The Legislature has not enacted legislation to clarify the classification of R & D equipment. However, Act No. 550 of 1986 was enacted to provide a \$300 tax on the sales tax imposed on the sale of R & D machinery and equipment and to allow a five year property tax exemption on R & D facilities in the same manner provided in Section 12-37-220A(7). Section 12-37-220A(7) provides a five year exemption for a manufacturer's real property and equipment. This illustrates that the Legislature intended to allow a special treatment for the R & D equipment as well as the R & D real property.

Thus, it appears the proper application of 12-43-220 is to classify the R & D equipment as well as the R & D real property as not used in the conduct of the business of the manufacturer.

Having concluded that the R & D equipment is not used in the conduct of the business of the manufacturer, the question turns to valuation. The valuation procedure in Section 12-37-930 is applicable to a manufacturer's machinery and equipment used in the conduct of the manufacturing business, thus, this section would not be applicable. Regulations 117-108 and 117-110 provide for the valuation of business personal property or property belonging to merchants and related businesses. Regulation 117-108 provides that businesses classified as Division I, Major Group 73 of the SIC Manual are valued under this procedure. This group includes research and development laboratories not related to manufacturing. The valuation method prescribed by Regulation 117-110 is original cost reduced by income tax depreciation but not below 10% of original cost. Thus, a manufacturer's R & D equipment not used in the business of the manufacturer, would be valued as business personal property as provided by Regulation 117-110.

As the R & D equipment would be valued as business personal property rather than property used in the conduct of a manufacturer's business, it should be returned on a P.T. 100 rather than a P.T. 300. However, if procedures are revised to allow the valuation of the R & D equipment as business personal property on the P.T. 300, then it may be returned on the P.T. 300.

Conclusion:

1. A manufacturer's R & D equipment should be classified in the same manner as the R & D real property which is not considered used by a manufacturer in the conduct of the business of a manufacturer. The R & D equipment of a manufacturer should be returned to the Commission on form P.T. 100 as business personal property.