New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-14(1)C
Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C121120A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [redacted] Petitioner asks whether certain purchases qualify for the qualified emerging technology companies ("QETC") facilities, operations and training credit for research and development property or qualified research expenses. We conclude that the purchases will qualify as research and development property to the extent the purchases constitute tangible property used in research and development. The purchases will not qualify as qualified research expenses.

Facts

In 2011, Petitioner purchased from an unrelated company three patents, prototypes, designs, manufacturing know-how, trade secrets, and other technological know-how related to the production of the hollow metal golf ball.

Analysis

For taxable years ending before January 1, 2012, Tax Law § 210.12-G provides that a QETC facilities, operations and training credit may be claimed by an eligible taxpayer that meets the definition of a QETC under Public Authorities Law ("PAL") § 3102-e and specifically for the activities referenced under PAL § 3102-e(1)(b). To qualify as a QETC specifically for activities referenced in PAL § 3102-e(1)(b), a business must meet the primary products or services test. *See* TSB-M-12(9)C,(8)I. Additional criteria for the credit are that a taxpayer must have: (1) 100 or fewer full-time employees of which at least 75% of those employees are employed in New York; (2) a ratio of research and development funds to net sales of 6% or greater during the taxable year; and (3) gross revenues, including gross revenues of affiliates and related members, of no more than $20 million for the taxable year immediately preceding the year the taxpayer is allowed to claim the credit. *See* Tax Law § 210.12-G(1)(b). This opinion does not address whether or not the Petitioner qualifies as a QETC under the PAL and for the activities covered by PAL § 3102-e(1)(b), and meets the eligibility requirements required by Tax Law § 210.12-G(1)(b), and assumes for purposes of this opinion that Petitioner meets these requirements.

The credit is the sum of the following amounts:

(1) 18% of the cost or other basis for federal income tax purposes of research and development property;

(2) 9% of qualified research expenses paid or incurred by the taxpayer during the taxable year; and

(3) 100% of qualified high technology training expenses. *See* Tax Law § 210.12-G(1)(c) (d) & (e).

The credit may not exceed $250,000 per taxable year. *See* Tax Law § 210.12-G(1)(f).

The credit amount for research and development property is 18% of the cost or other basis for federal income tax purposes of research and development property, as defined in Tax Law § 210.12(b), that is acquired by purchase under Tax Law § 179(d), and is placed in service during the taxable year. Tax Law § 210.12(b) requires that the property be tangible property and be used for purposes of research and development in the experimental or laboratory sense. Also, for purposes of the research and development property portion of the credit, an eligible taxpayer will be allowed a credit for 18% of the: (1) cost or other basis for federal income tax purposes of property used in the testing or inspection of materials and products; (2) costs or expenses associated with quality control of the research and development; (3) fees for the use of sophisticated technology facilities and processes; and (4) fees for production or eventual commercial distribution of materials and products from the activities of an eligible taxpayer where the activities fall under the activities in PAL § 3102-e(1)(b).

Petitioner's property purchases consist of three patents, prototypes, designs, manufacturing know-how, trade secrets and other technological know-how related to the production of the hollow metal golf ball. As stated above, the credit for research and development property requires that the property be tangible property. Although the term "tangible property" is not defined in the QETC facilities, training and credit section, the general definition section of Article 9-A defines "tangible personal property" as corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and does not mean money, deposits in banks, shares in stock, bonds, notes, credits or evidences of an interest in property and evidences of debt. *See* Tax Law § 208.11.

Therefore, Petitioner's purchase of intangible property, including the patents, trade secrets, manufacturing know how and other technical know-how, will not qualify as research and development property. Petitioner's purchase of the prototypes and designs of tangible property may qualify as research and development property if the property is used for research and development in the experimental or laboratory sense. The case law interpreting the federal expense deduction for research and experimental expenditures in IRC § 174 provides guidance on how to interpret this standard. Property is used for research and development in the experimental or laboratory sense if (1) the information available to the Petitioner does not establish the capability or method for developing or improving a product or process (i.e. an uncertainty exists); and (2) the property is used in an activity intended to discover information that would eliminate this uncertainty. *See Union Carbide Corp and Subsidiaries v. C.I.R.*, 97 T.C.M. 1207 (2009), citing 26 CFR 1.174-2. Also, if the contract for the purchase of property did not itemize amounts for qualifying and non-qualifying research and development property,

Petitioner may allocate a reasonable portion of the purchase price to the qualifying property amounts.

The credit amount for "qualified research expenses" is applicable to expenses associated with in-house research and processes, and costs associated with the dissemination of the results of the products that directly result from those research and development activities. *See* Tax Law § 210.12-G(1)(d). In addition, certain costs associated with patents, such as costs associated with the preparation of patent applications and patent application fees, qualify However, because Petitioner purchased the patents and other property from another company, and the property was not developed and created "in house" by Petitioner, the expenses do not qualify as qualified research expenses.

DATED: January 27, 2014

/S/
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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.