

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-86 (12) C
Corporation Tax
June 17, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO.C860429A

On April 29, 1986, a Petition for Advisory Opinion was received from Bausch & Lomb Incorporated, One Lincoln First Square, Rochester, New York 14604.

The issues raised are (I) the extent to which tangible property, including buildings and structural components of buildings, qualifies for the research and development credit provided by section 210.18 of the Tax Law and (II) if the entire facility does not qualify, what is the proper method of allocating construction costs to specific qualifying property.

The petitioner is developing plans to construct a new research and development facility adjacent to its present manufacturing/office building located at 1400 North Goodman St., Rochester, New York. This state of the art technical center will house the research and development activities of the company's solutions, ophthalmic, pharmaceutical and contact lens businesses. The building will be used to conduct research and for product and process development.

The total area of new construction for the proposed facility is 98,500 square feet, identified as follows:

Laboratories	34,000 Sq. Ft.
Offices	14,000 Sq. Ft.
Shell Space	10,000 Sq. Ft.
Support and Non-Assignable	<u>40,500</u> Sq. Ft.
	<u>98,500</u>

The various components are to be used as follows:

Laboratory Space

The laboratory space will encompass the following types of functions:

- Microbiological Research
- Analytical Research
- Polymer Synthesis
- Chemical Research
- Formulation Development (Pre-manufacturing simulation with clean rooms and stability testing)

Office Space

The 14,000 square feet of office space will be subdivided by class of research and development personnel as follows:

Lab Technicians	2,200 Sq. Ft.
Professionals	9,400 Sq. Ft.
Managers	2,400 Sq. Ft.

Laboratory cubicles for technicians are strategically located adjacent to the labs, but in widened corridor space. Technicians will use these cubicles to review results of laboratory tests, to access personal computer terminals in connection with tests being performed, and to compile data and prepare R & D reports. Professionals will use their offices to develop and monitor specific lab procedures, which, in most cases, will be conducted by technicians. The managers will be dealing with administrative matters exclusively relating to research and development such as planning, staffing and budgetary constraints.

Shell Space

Due to the potential for unforeseen changes in research and development procedures, shell space has been included in the current construction plans. As individual research groups expand, the shell space will be converted to usable space. This shell space not only includes future lab space, but also private offices and cubicles to support anticipated growth. As industry trends change and new product ventures arise, laboratories must respond to these challenges. Adaptability is a mandatory feature of this building due to the generic nature of the planning module and systems design.

Support and Non-Assignable Space

Support and non-assignable space includes:

- Mechanical and electrical equipment rooms which provide ventilation to the laboratories.
- Storage space which includes the storing of chemicals under refrigeration.
- Interaction space. Departmental interaction was a key issue in planning the proposed facility. The desire to create this interaction and encourage the sharing of thoughts and ideas between researchers was an influencing parameter in the design of the building.
- Function support space. Includes vertical transportation (elevators, stairs) and general building circulation (corridors, etc).

Petitioner states that the proposed facility is similar to a "special purpose structure" as defined in the Federal investment tax credit regulations in so far as the structure which houses the research function is actually an integral part of the research activity. This building is closely related to the actual use of the property due to the fact that:

- The structure has been specifically designed to provide for the stress and other demands of the research and development testing, and
- The structure could not be economically used for other purposes. Conversion of the property to an alternative use would not be cost beneficial.

Petitioner also states that since the sole purpose of constructing this facility was to conduct research, and the entire structure will serve to support research, the total cost of the building should qualify for the credit. Due to the nature of construction costs, the petitioner intends to aggregate the components of the capitalized building costs such as the building shell, sitework, chilled water plant, construction fees, construction assessments and architectural and engineering fees. The resulting total cost figure will agree with the federal income tax basis of the property and will also serve as the total new building cost subject to the research and development credit. Non-building items such as movable lab equipment will be reviewed separately to determine whether they are subject to the research and development credit. Nothing in this Advisory Opinion is intended to indicate whether such non-building items are eligible for the research and development credit.

This facility will be constructed by Petitioner after June 30, 1982; it will be recovery property with respect to which an accelerated cost recovery system deduction is allowable under section 168 of the Internal Revenue Code; it will have a useful life of more than four years; it will be acquired by purchase as defined in section 179(d) of the Internal Revenue Code and will have a situs in New York State.

Section 210.18 of Article 9-A of the Tax Law provides that a taxpayer shall be allowed a credit against the tax imposed by Article 9-A at the rate of 10% of the cost or other basis of tangible personal property and other tangible property, including buildings and structural components of buildings, which:

- (1) are acquired, constructed, reconstructed or erected by the taxpayer after June 30, 1982;
- (2) are depreciable pursuant to section 167 of the Internal Revenue Code or is recovery property with respect to which an accelerated cost recovery system deduction is allowable under section 168 of the Internal Revenue Code;
- (3) have a useful life of four years or more;
- (4) are acquired by purchase as defined in section 179(d) of the Internal Revenue Code;
- (5) have a situs in New York State; and

- (6) are used or are to be used by the taxpayer for the purpose of research and development in the experimental or laboratory sense.

The term "research and development in the experimental or laboratory sense" does not include:

- (1) the ordinary testing or inspection of materials or products for quality control;
- (2) efficiency surveys;
- (3) management studies;
- (4) consumer surveys;
- (5) advertising;
- (6) promotions; or
- (7) research in connection with literary, historical or similar projects.

ISSUE I

Petitioner's research and development facility, including the building and structural components thereof, qualify for the research and development credit to the extent used for research and development in the experimental or laboratory sense. The specific components of Petitioner's facility qualify as property used in research and development as follows:

- (1) Laboratory Space - All of the laboratory space qualifies.
- (2) Office Space - All of the office space for the lab technicians and professionals qualifies since such use of office space is a direct and necessary part of the research process. The managers' office space qualifies since it is used solely for managing research and development matters and, therefore, is deemed to be an integral part of the research process.
- (3) Shell Space - Section 210.18 allows a credit for "buildings and structural components of buildings which are used or are to be used by the taxpayer for the purpose of research and development...." Based upon the facts presented by Petitioner, it has been adequately demonstrated that the shell space is to be used for research and development and, as such, will qualify. However, if in the future it is determined that this space is used for purposes other than research and development, a portion of the credit allowed for this space must be recaptured.
- (4) Support and Non-Assignable Space - (a) The mechanical and electrical equipment rooms which provide ventilation to the laboratories qualify since

they create the environment necessary for research to be conducted. (b) Since all of the storage space is used to store research and development materials, the entire space qualifies. (c) The interaction space and the function support space qualify to the extent the rest of the building qualifies. That is, since 100% of the remainder of the building qualifies, all of the interaction space and the function support space qualify.

ISSUE II

Inasmuch as the entire facility is deemed to be used in research and development, no allocation of costs is necessary. Accordingly, this issue need not be addressed in this Advisory Opinion.

It should be noted that section 210.18(c) of the Tax Law states, in part, that the research and development credit is not allowed if an investment tax credit is claimed pursuant to section 210.12 of the Tax Law.

Section 210.12(f) of the Tax Law provides that:

"(f) At the option of the taxpayer,...research and development facilities which qualify for elective deduction under subparagraphs two and three of paragraph (e) of subdivision three of this section may be treated as property principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing, provided the property otherwise qualifies under paragraph (b) of this subdivision, in which event, a deduction shall not be allowed under such paragraph (g), a credit shall not be allowed under such subdivision eleven and a deduction shall not be allowed under such paragraph three of paragraph (e)."

In addition, section 210.12-A(a) of the Tax Law provides for an employment incentive tax credit and states, in part:

"(a) Where a taxpayer is allowed a credit under subdivision twelve, with respect to property, the acquisition, construction, reconstruction or erection of which commenced on or after the first day of January, nineteen hundred seventy-six, the taxpayer shall be allowed a credit for each of the three years next succeeding the taxable year for which the credit under subdivision twelve is allowed with respect to such property, whether or not deductible in such taxable year or in subsequent taxable years pursuant to paragraph (e) of such subdivision twelve, of fifty per cent of the credit allowed under subdivision twelve; provided, however, that the credit allowable under this subdivision for any taxable year shall only be allowed if the average number of employees during such taxable year is at least one hundred one percent of the average number of employees during the taxable year immediately preceding the taxable year for which the credit under subdivision twelve is allowed. . . ."

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Accordingly, since the property in question qualifies for the research and development deduction of section 210.3(e) of the Tax Law, it may be treated as property principally used by Petitioner in the production of goods by manufacturing. Since the property otherwise qualifies under section 210.12(b) of the Tax Law, Petitioner may elect, pursuant to section 210.12(f) of the Tax Law, to claim the investment tax credit in lieu of the research and development credit allowable pursuant to section 210.18 of the Tax Law. If Petitioner elects to claim the investment tax credit and in succeeding taxable years qualifies, pursuant to section 210.12-A of the Tax Law, for the employment incentive tax credit, such credit may also be claimed for the appropriate taxable years.

DATED: June 17, 1986

s/Frank J. Puccia
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.