Declaratory Order 2020-01

Request for Ruling Regarding the Taxability of the Taxpayer's Cleanrooms Under the Sales and Use Tax

Request for Ruling

The Taxpayer requested a declaratory order ("Ruling Request") to determine three questions:

1.) Is the installation of modular cleanrooms considered a construction contract with the Taxpayer being deemed the end user of tangible personal property, or would the installation of cleanrooms be deemed the sale of tangible personal property?

2.) Would the Taxpayer's cleanroom qualify for Rhode Island's sales and use tax exemption associated with purchases by a manufacturing industry for the use in its manufacturing process under R.I. Gen. Laws 44-18-30(22) or purchases made associated with research and development under R.I. Gen. Laws 44-18-30(42)?

3.) If a properly completed Rhode Island Manufacturer's Exemption Certificate or Research and Development Exemption Certificate is received from a customer, can this exemption be properly accepted by the Taxpayer?

Facts

The facts set forth below are taken from the statement of facts presented in the Ruling Request received by the Tax Division on July 8, 2019.

The Taxpayer is engaged in the business of designing, manufacturing, installing, and servicing cleanrooms for customers in the manufacturing, pharmaceutical, biotechnology, and research and development fields. The Taxpayer's model is to design, manufacture, and install a prefabricated, modular cleanroom on site at the customer's facility. The Taxpayer's methodology for installation of cleanrooms differs from the prior stick-built methodology that used standard building materials and were affixed to real property in a permanent fashion so as to become part of the real property in the same fashion as any other construction contract. By contrast, modular cleanrooms involve the fabrication of component parts such as walls and ceilings off-site with ultimate delivery and installation at the end user's facility.

The Taxpayer advertises its cleanroom as a removable self-contained space within a larger space with the intent to treat the room as a type of equipment. The cleanroom floor is attached to a concrete floor with removable masonry screws. The cleanroom is designed and installed so that it can be removed or relocated within or outside a facility without permanent damage to the realty surrounding the cleanroom or the realty in which the cleanroom comes into contact.

The Taxpayer asserts that for federal tax purposes, modular cleanrooms qualify for treatment as a capital equipment expense, providing for depreciation over a seven-year useful life as opposed to being treated as a permanent structural component to a building that must be depreciated over a thirty-nine-year life. Financial institutions offer equipment leasing options for the Taxpayer's customers in order to facilitate the purchase of the cleanrooms. The Taxpayer's cleanrooms are used by its clients to ensure extremely low levels of airborne contamination for various applications such as specialized industrial production, scientific research, and research and development. Cleanrooms are a vital component of the Taxpayer's customers' operations.

Ruling Requested

The Taxpayer's cleanrooms are deemed to be tangible personal property. Whether a particular cleanroom qualifies for a manufacturing equipment or research and development exemption under R.I. Gen. Laws §§ 44-18-30(22) and 44-18-30(42), respectively, depends on the facts and circumstances of each transaction. However, the Taxpayer may accept a fully completed Rhode Island Manufacturer's Exemption Certificate or Research and Development Exemption Certificate from a customer.

Pertinent Statutory and Regulatory Law

R.I. Gen. Laws § 44-18-18 imposes a seven percent (7%) tax on all sales at retail in the state of Rhode Island. R.I. Gen. Laws § 44-18-20 imposes a complementary use tax on all tangible personal property that is stored, used, or otherwise consumed in Rhode Island. R.I. Gen. Laws § 44-18-16 defines tangible personal property as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses." R.I. Gen. Laws § 44-18-25 presumes that the gross receipts and use of tangible personal property in Rhode Island are subject to tax until the taxpayer proves otherwise.

Under 280-RICR-20-70-54 ("Contractors and Subcontractors"), a company that contracts to perform a job, and acquires materials to complete the job, must pay the sales or use tax at the time it acquires the materials, except where the contractor acts as a retailer. *See* Declaratory Ruling 2000-03.

280-RICR-20-70-54.6(C) further provides that where a "contractor or subcontractor acts as a retailer selling tangible personal property in the same manner as other retailers and is required to install a complete unit of standard equipment, requiring no further fabrication but simply installation, assembling, applying or connecting services," that contractor or subcontractor "is primarily a RETAILER of tangible personal property and must have a permit to make sales at retail…." A retailer selling tangible personal property "should segregate the full retail selling price of such property from the charge for installation, as the tax applies only to the retail price of the property." *Id.*

R.I. Gen. Laws § 44-18-12 defines "[s]ales price" as "the measure subject to sales tax and means the total amount of consideration… for which personal property or services are sold… without any deduction for… (ii) [t]he cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of

the seller; (iii) [c]harges by the seller for any services necessary to complete the sale, other than delivery and installation charges; (iv) [d]elivery charges…." "Sales price" does not include "[t]he amount charged for labor or services rendered in installing or applying the property sold when the charge is separately stated by the retailer to the purchaser…." R.I. Gen. Laws § 44-18-12(b)(ii).

In Rhode Island, there is a three-part test for determining if a chattel, i.e. tangible personal property, has become a fixture, i.e. part of the realty:

1. Annexation of the chattel to the realty, either actual or constructive;
2. Adaptation or application to the use or purpose to which that part of the realty the chattel is connected is appropriated;
3. Intention to make the chattel a permanent accession to the freehold.

Prospecting Unlimited v. Norberg, 376 A.2d 702 (R.I. 1977) (citations omitted). Certain chattels, once they are deemed to be fixtures, "are declared to be real estate when owned by the owners of the real estate to which they are attached." R.I. Gen. Laws § 44-4-3.

R.I. Gen. Laws § 44-18-30(22) provides an exemption from the Rhode Island Sales & Use Tax for manufacturing purposes. R.I. Gen. Laws § 44-18-30(42) provides an exemption from Rhode Island Sales & Use Tax for equipment used for research and development ("R&D"). Regulation 280-RICR-20-70-19 ("Manufacturing, Property and Public Utilities Service Used In") further clarifies the manufacturing exemptions provided by R.I. Gen. Laws § 44-18-30(22).

R.I. Gen. Laws § 44-18-30(22) provides in pertinent part:

(22) Manufacturing machinery and equipment.

(i) From the sale and from the storage, use, or other consumption in this state of tools, dies, molds, machinery, equipment (including replacement parts), and related items to the extent used in an industrial plant in connection with the actual manufacture, conversion, or processing of tangible personal property, or to the extent used in connection with the actual manufacture, conversion, or processing of computer software as that term is utilized in industry numbers 7371, 7372, and 7373 in the standard industrial classification manual prepared by the Technical Committee on Industrial Classification, Office of Statistical Standards, Executive Office of the President, United States Bureau of the Budget, as revised from time to time, to be sold, or that machinery and equipment used in the furnishing of power to an industrial manufacturing plant. For the purposes of this subdivision, "industrial plant" means a factory at a fixed location primarily engaged in the manufacture, conversion, or processing of tangible personal property to be sold in the regular course of business;

(ii) Machinery and equipment and related items are not deemed to be used in connection with the actual manufacture, conversion, or processing of tangible personal property, or in connection with the actual manufacture, conversion, or processing of computer software as that term is utilized in industry numbers 7371, 7372, and 7373 in the standard industrial classification manual prepared by the Technical Committee on Industrial Classification, Office of Statistical Standards, Executive Office of the President, United States Bureau of

the Budget, as revised from time to time, to be sold to the extent the property is used in administration or distribution operations;

(iii) Machinery and equipment and related items used in connection with the actual manufacture, conversion, or processing of any computer software or any tangible personal property that is not to be sold and that would be exempt under subdivision (7) or this subdivision if purchased from a vendor or machinery and equipment and related items used during any manufacturing, converting, or processing function is exempt under this subdivision even if that operation, function, or purpose is not an integral or essential part of a continuous production flow or manufacturing process;

(iv) Where a portion of a group of portable or mobile machinery is used in connection with the actual manufacture, conversion, or processing of computer software or tangible personal property to be sold, as previously defined, that portion, if otherwise qualifying, is exempt under this subdivision even though the machinery in that group is used interchangeably and not otherwise identifiable as to use.

R.I. Gen. Laws § 44-18-30(42) exempts "[f]rom the sale and from the storage, use, or other consumption of equipment to the extent used for research and development purposes by a qualifying firm." The statute defines a "qualifying firm" as "a business for which the use of research and development equipment is an integral part of its operation…" Equipment is defined as "scientific equipment, computers, software, and related items."

Regulation 280-RICR-20-70-59 ("Qualifying Research and Development Firms") defines "[r]esearch and development" as "experimental or laboratory activity that has as its ultimate goals the development of new products, the improvement of existing products, the development of new uses for existing products or the development or improvement of methods for producing products." Excluded from research and development is "testing or inspection of materials or products for quality control purposes, efficiency surveys, management studies, consumer surveys or other market research, advertising or promotional activities, or research in connection with literary, historical or similar projects." 280-RICR-20-70-59.5(C). The burden of proof to establish the applicability of an exemption is on the taxpayer by production of records to support the use of the equipment for research and development within the parameters of the statutes and regulations. 280-RICR-20-70-59.6(B).

Section 317(C) of the Streamlined Sales and Use Tax Agreement ("SSUTA" or "Streamlined") (last amended December 20, 2019), to which Rhode Island is a signatory member, requires Streamlined member states to accept fully completed exemption certificates presented by sellers. The section states in pertinent part: "Each state shall relieve a seller of the tax otherwise applicable if the seller obtains a fully completed exemption certificate or captures the relevant data elements required under the Agreement within 90 days subsequent to the date of sale." This same provision is codified in R.I. Gen. Laws § 44-18.1-18(C).[1]

[1] R.I. Gen. Laws § 44-18.1-18(C) states: "Each state shall relieve a seller of the tax otherwise applicable if the seller obtains a fully completed exemption certificate or captures the relevant data elements required under the Agreement within 90 days subsequent to the date of sale."

Taxpayers claiming statutory tax benefits must demonstrate not only that a tax exemption or deduction exists but that they clearly and unequivocally come within the ambit of its provisions. *Cookson v. Clark*, 610 A.2d 1095, 1098 (R.I. 1992); *Rhode Island Lithograph Corp. v. Clark*, 519 A.2d 589, 591 (R.I. 1987). Furthermore, statutes conferring such tax benefits must be strictly and narrowly construed, *Fleet Credit Corp. v. Frazier*, 726 A.2d 452, 454 (R.I. 1999); *Rice Machinery Co. v. Norberg*, 391 A.2d 66, 70 (R.I. 1978); *Red Fox Gingerale Co. v. Norberg*, 217 A.2d 466, 467 (R.I. 1966), with all doubts and ambiguities resolved against the taxpayer and in favor of the taxing authorities. *Roger Williams General Hospital v. Littler*, 566 A.2d 948, 950 (R.I. 1989); *American Hoescht Corp. v. Norberg***,** 462 A.2d 369, 371 (R.I. 1983).

Discussion

The cleanrooms at issue in this ruling are tangible personal property subject to sales and use tax for several reasons. First, the Taxpayer does not appear to engage in construction contracts as defined by Regulation 280-RICR-20-70-54.6 since it does not repair, alter, improve, remodel, or construct real property. Instead, it assembles mobile cleanrooms that may be readily attached to and/or detached from real estate. The Ruling Request refers several times to the cleanrooms as "modular" and "removable", thus demonstrating an intent to not be permanently affixed to real estate. Additionally, the cleanrooms here are similar to the modular homes that were upheld as tangible personal property in *Prospecting Unlimited.* Although the Taxpayer erects the cleanrooms at issue here, unlike the contractor in *Prospecting Unlimited*, the Taxpayer here is clearly erecting pieces of property that are not permanently affixed to real estate.

According to the Ruling Request, the components of the cleanroom, including the walls and ceilings, are fabricated off-site with delivery and installation of the components at the end user's facility. It is unclear whether the fabrication of the materials occurs in Rhode Island. To the extent fabrication labor occurs in Rhode Island, it is included in the cleanroom's sales price and subject to tax. However, separately stated installation labor charges are not taxable. R.I. Gen. Laws 44-18-12(a)(iii). Since all fabrication occurs prior to installation, under Regulation 280-RICR-20-70-54 the Taxpayer "acts as a retailer selling tangible personal property in the same manner as other retailers and is required to install a complete unit of standard equipment, requiring no further fabrication but simply installation, assembling, applying or connecting services. In such instances the contract will not be regarded as one for improving, altering or repairing real property." Thus, the cleanroom does not become a fixture of the customer's realty and is taxable as tangible personal property.

The Taxpayer, as a "retailer engaging in business in this state and making sales of tangible personal property," is required to collect the sales tax on those sales at the time of making the sales. R.I. Gen. Laws §§ 44-18-19 and 44-18-22. The installation of the cleanroom is not taxable as long as the installation charge is stated separately on an invoice for the sale of the cleanroom.

Whether a cleanroom provided by the Taxpayer is exempt from Rhode Island sales or use tax under R.I. Gen. Laws § 44-18-30(22) or R.I. Gen. Laws § 44-18-30(42) depends on the facts and circumstances of each transaction. However, the Taxpayer may accept a Manufacturer's Exemption Certificate or a Research and Development Exemption Certificate from a customer.

R.I. Gen. Laws § 44-18.1-18(C) and Section 317(C) of the SSUTA require the state to relieve a seller of sales or use tax if the seller obtains a fully completed exemption certificate.

Ruling

The Taxpayer's cleanrooms are tangible personal property subject to Rhode Island Sales & Use Tax. Whether a particular cleanroom qualifies for a manufacturing or research and development exemption under R.I. Gen. Laws §§ 44-18-30(22) and 44-18-30(42), respectively, depends on the facts and circumstances of each transaction. However, the Taxpayer may accept a fully completed Rhode Island Manufacturer's Exemption Certificate or Research and Development Exemption Certificate from a customer.

This ruling is limited to the facts stated herein and may be relied upon by the Taxpayer and shall be valid unless expressly revoked because (1) the applicable statutory provisions of law are amended in a manner that requires a different result; (2) the underlying facts described herein materially change; or (3) a decision on point has been issued by the Rhode Island or Federal courts.

Neena S. Savage
Tax Administrator
January 27, 2020