

# **State of Rhode Island - Division of Taxation**

## **Tax Credits/Deductions**

### **Regulation CR 88-03**

#### **Elective Deduction for New Research and Development Facilities**

I. For taxable years beginning on or after July 1, 1974, at the election of a taxpayer who is subject to the income tax imposed by Chapter 44-11 or 44-30, there shall be deducted from the portion of its entire net income allocated within this state, a one-year write-off of new research and development facilities, as described in 44-31-2, in lieu of depreciation or investment tax credit. The research and development deduction shall be allowed on all qualifying depreciable tangible property including buildings constructed, reconstructed, erected or acquired during the taxable year, provided, however, that a research and development deduction will be allowed against the entire net income of only that corporation, included in a consolidated Rhode Island tax return, that qualifies for the research and development deduction and will not be allowed against the entire net income of other corporations that may join in the filing of a consolidated Rhode Island tax return with such corporation. In order to qualify for this deduction from allocated net income, the property must:

- (a) be new property (not used);
- (b) be depreciable pursuant to Sec. 167 of the Internal Revenue Code;
- (c) be acquired by purchase as defined in Sec. 179(d) of the Internal Revenue Code;
- (d) have a situs in this state;
- (e) be used or acquired for use by the taxpayer in Rhode Island in its trade or business for the purposes of research and development in the experimental or laboratory sense;
- (f) not have been allowed an election for amortization of air or water pollution control facilities;
- (g) not have been allowed an investment tax credit;
- (h) not be leased to or by the taxpayer.

II. TIME FOR AND SCOPE OF ELECTION--The election provided by 44-31-1 may be made for any taxable year beginning on or after July 1, 1974, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

III. The deduction for new research and development facilities shall be allowed in the year in which the expenditure is paid or incurred, provided, however, that only the portion of expenditures that is property attributable to construction, reconstruction, erection or acquisition on or after July 1, 1974 is taken into account. Any unused deduction may be carried forward for three years. A research and development deduction shall be applied only after any net operating loss deduction has been applied for that year.

IV. For the purpose of this regulation, the term "research and development deduction" means the elective deduction under 44-32-1 for expenditures paid or incurred during the taxable year for new depreciable tangible property including buildings which is used or to be used by the

taxpayer in its trade or business for the purpose of research or development in the experimental or laboratory sense. The term "research and development" includes, generally, the development of an experimental or pilot model, a plant process, a product, a formula, an invention or similar property and the improvement of already existing property of the type mentioned. The term "research and development" does not include the ordinary testing or inspection of materials or products for quality control, efficiency surveys, management studies, consumer surveys, advertising, promotions or research in connection with literary, historical or similar projects.

V. The research and development deduction shall be allowed only on condition that entire net income for the taxable year and all succeeding taxable years be computed without the deduction of any such expenditures allowed for federal purposes and without any deduction for depreciation of the same property except to the extent that its basis may be attributable to factors other than such expenditures. In case only a part of the deduction for research and development facilities is allowable pursuant to this section and a deduction is fully allowable for federal income tax purposes, then such expenditures and depreciation as allowed for federal purposes shall be proportionately reduced for the taxable year and all succeeding taxable years.

VI. A taxpayer shall not be allowed a deduction with respect to tangible property leased by it to any other person or corporation or leased from any other person or corporation. For the purpose of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property shall be considered a lease unless such contract or agreement is treated for federal income tax purposes as an installment purchase rather than a lease.

In order to be considered the owner of such property, a taxpayer must be allowed federal depreciation on such property. Since property rented to others does not qualify for the deduction, the deduction shall not be allowed where the purchaser is not the user of the qualified property, even where the purchaser and the user may be included in a consolidated federal and/or a consolidated state tax return.

VII. A recomputation of a portion of the research and development deduction is required where property on which such deduction has been allowed is used for purposes other than research and development to a greater extent than originally reported, except where the property was in qualified use in Rhode Island for its entire useful life. As used in 44-32-1(1)(a) and this paragraph, the phrase "purposes other than research and development" includes any change in use of the property in whole or in part from that which originally qualified the property for the research and development deduction. For the purpose of this paragraph, the useful life of the property shall be the same as the taxpayer uses for depreciation purposes when computing the federal tax liability.

The following are examples of events that may require a recomputation of the research and development deduction:

- (a) Liquidation or legal dissolution;
- (b) Exchange of property;
- (c) Foreclosure of a security interest;
- (d) Retirement prior to expiration of useful life;
- (e) Involuntary conversion arising from fire, storm, shipwreck, or other casualty, or from theft;

- (f) Leasing property;
- (g) Removal of property from Rhode Island;
- (h) Termination of ownership interest;
- (i) Reduction or cessation of qualified use;

VIII. Generally, the format for the computation of the research and development deduction to be recomputed as Rhode Island income when the property is used for purposes other than for research and development will be;

Research and development deduction taken on property easing to qualify X Useful Life (in months) - Qualified Use (in months) = Useful life (in months)

Research and development deduction recomputed is reportable as additional Rhode Island income for the year or years for which the deduction was allowed. Any tax that may be due as a result of this recomputation must be paid at the time of reporting such recomputation.

IX. A recomputation of the research and development deduction is not required if all of the following elements are present in the transaction:

- (a) The property is transferred from one taxpayer to another by a transaction in which the basis of the property in the hands of the transferee is determined in whole or in part by reference to the basis in the hands of the transferor, or a mere change in the form of the taxpayer's business, and
- (b) the acquiring taxpayer is taxable under Chapters 44-11 or 44-30 of the Rhode Island General Laws, and
- (c) the property continues to be in qualified use.

If all of the preceding elements are present in the transaction, such transfer will not require a recomputation of the research and development deduction, and any unused research and development deduction on the transferred property may be passed through to and carried forward by the acquiring taxpayer.

If the property in the hands of the acquiring taxpayer is not in qualified use for its entire life, a recomputation of the research and development deduction by the acquiring taxpayer is required. In measuring the period of qualified use, the period during which the property was held by the transferor taxpayer and the acquiring taxpayer shall be taken into account.

A recomputation is required where a transfer is made other than to an acquiring taxpayer taxable under Chapters 44-11 or 44-30 (on the theory that the property is no longer in qualified use).

X. In any taxable year the gain or loss entering into the computation of federal taxable income from the sale or other disposition of property before the end of its useful life on which a research and development deduction has been allowed, shall be disregarded in computing entire net income and there shall be added to or subtracted from the portion of entire net income allocated within the state the gain or loss upon such sale or other disposition. In computing such gain or loss the basis of the property sold or disposed of shall be adjusted to reflect the research and development deduction allowed under 44-32-1. No loss will be recognized with respect to a sale or other disposition of qualified property to a taxpayer whose acquisition thereof is not a

purchase as defined in section 179(d) of the Internal Revenue Code.

XI. A sale, as described in paragraph X, will include any transaction giving rise to both realized and recognized gain or loss as those terms are understood for federal income tax purposes. Any transaction not giving rise to both realized and recognized gain or loss for federal income tax purposes will not constitute a sale. The terms "or other disposition" appearing in paragraph X, and "disposed of" appearing in 44-32-1(5) are defined as any transaction substantially equivalent to a sale.

Any event or transaction not constituting a sale or other disposition will be subject to the rules regarding recomputations under 44-32-1(a) and paragraphs VII, VIII and IX of this regulation.

In any case where property which has been the subject of a research and development deduction is liable to a recomputation under 44-32-1(a) and paragraphs VII, VIII and IX of this regulation, and is subsequently sold or otherwise disposed of by the taxpayer, the subsequent sale will be accountable to 42-35-1(5) and paragraph X of this regulation. However, an appropriate adjustment shall be made to reflect the previous recomputation.

XIII. The term "taxpayer" as used in the regulation shall mean and include, as appropriate, an individual, a partnership, a corporation or other taxable entity.

R. GARY CLARK TAX ADMINISTRATOR

DATE FILED: December 9, 1988

EFFECTIVE DATE: December 31, 1988

THIS REGULATION AMENDS AND SUPERCEDES THE REGULATION ENTITLED "ELECTIVE DEDUCTION FOR NEW RESEARCH AND DEVELOPMENT FACILITIES" PROMULGATED ON JANUARY 20, 1977.