



Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

NUMBER: 3126.2009

ISSUE DATE: February 2, 2009

Manufacturers' Machinery and Equipment Exemption — Prototypes

The Department has issued a series of excise tax advisories (ETAs) to address questions regarding the retail sales and use tax exemption provided by RCW 82.08.02565 and 82.12.02565, commonly referred to as the manufacturers' machinery and equipment exemption (M&E exemption). This ETA is issued to address the application of the M&E exemption to prototypes. Please refer to ETA 3117.2009 for a current list of the issues covered by this series.

In addition to the issues discussed in this ETA series, machinery and equipment must also meet the other requirements of the statutes to be eligible for the exemption. For example, some of the requirements include:

- Purchaser/User must be a manufacturer, processor for hire, or a tester for a manufacturer or processor for hire,
- Must purchase machinery or equipment (devices, industrial fixtures, support facilities, pollution control equipment),
- The machinery or equipment must be used directly in a manufacturing, research and development, or testing operation,
- The machinery or equipment must have a useful life of one year or more, and
- The machinery or equipment must be used more than 50% of the time on an eligible activity.

Therefore, readers are advised that RCW 82.08.02565, RCW 82.12.02565, and WAC 458-20-13601 should also be referenced when making determinations about taxability.

The Department has been asked to provide guidance on the taxability of "prototypes."

Principles

Eligibility of prototypes for the M&E exemption is based on the following principles:

- (1) Used directly tests – Eligibility for the M&E exemption is determined on the basis of how property is used, not on how property is identified by name. The M&E exemption focuses on the use of property, and the term used to identify something is largely immaterial.

All ETAs were cancelled on February 2, 2009 and those which had a continued use were rewritten and reissued using a new numbering system. The new ETAs are numbered using the following format 3nnn.yyyy. The Department of Revenue issued ETA 3001.2009 which includes a cross reference table showing the old and new ETA numbers for those ETAs that were rewritten.

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- (2) Machinery and equipment – Property eligible for the exemption must fit within the context of machinery and equipment as that phrase is defined in the M&E statute.
- (3) The property must be used as machinery and equipment – The M&E exemption is for the property used by the manufacturer in a manufacturing, testing, or research and development operation, to produce products and potential products. The M&E exemption is not available for the products themselves. Property, such as a prototype, that is the object (product) of manufacturing or research and development does not qualify under any used directly test.

Tax Treatment

Machinery and equipment used to produce a product is potentially eligible, but the product itself is not eligible unless its use meets one of the “used directly” tests. The M&E exemption has different “used directly” tests for manufacturing and for research and development. For a research and development operation a manufacturer need only show the prototype is “integral” to the operation. For a manufacturing operation a manufacturer has to meet one of seven used directly tests, such as “acts upon or interacts with tangible personal property.” Regardless of these differences in the statute, property that is the object of the research and development does not itself qualify for the exemption and property that is the object of the manufacturing activity does not itself qualify for the exemption. The thing being made is the object of the activity and as such is not “machinery and equipment” as that phrase is used in the M&E exemption.

If a prototype is not used to make, build, or test a different product or used in some supportive capacity (used directly) in stages of the manufacturing operation, its use does not qualify. Any product made by a manufacturer and used in a qualifying manner potentially qualifies for exemption – subject to not being the object of the activity itself. For example, a “prototype” used as a manufacturing mockup to calibrate tools will qualify as machinery and equipment. A prototype used as a test bed will qualify if it can be shown that the information gained from the test will be used for a different product or process, and will not be used to refine or change the product itself. The phrase “test bed” means that the prototype is used to test other property, and not the prototype itself. A “test bed” typically evaluates how property operates under a range of working conditions. If the prototype is being tested itself, then it is not being used as a “test bed.”

Presumption

In order to determine whether a product made by a manufacturer is eligible for the exemption, an examination of the facts, as supported by contemporaneous documentation or other credible evidence regarding the property’s use, must be undertaken.

The Department presumes that a manufacturer of an item that is being developed or manufactured is not using the property in a manner eligible for the M&E exemption. To overcome this presumption, the manufacturer must establish that the item is being used to test something other than itself. This determination will be done on a case by case basis, and will in each case be based on the individual facts and circumstances. For example, in order for a prototype of a fire extinguisher to be eligible for use in an R&D operation, use of the prototype must be part of activities relating to another product and not be in regard to R&D on the fire extinguisher itself.

The Department also presumes that a product and all of its components are the thing being tested. The burden is on the taxpayer to demonstrate, and support by contemporaneous documentation or other credible evidence, that the product is being used as a “test bed.” Documentation will need to reflect the basis for the activity and the intent of the manufacturer.