

Cite as Det. No. 15-0013, 34 WTD 401 (2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition Appealing a )	<u>D E T E R M I N A T I O N</u>
Ruling concerning )	
) )	No. 15-0013
) )	
... )	Registration No. ...
) )	

[1] RCW 82.04.260 – B&O TAX – SPECIAL RATE – “RESEARCH AND DEVELOPMENT” – DEFINITION. The definition of “research and development” in RCW 82.63.010 applies to the term “research and development” in RCW 82.04.260.

[2] RCW 82.04.260 – B&O TAX – SPECIAL RATE – “RESEARCH AND DEVELOPMENT” – CLINICAL TRIALS. Because a company conducting clinical trials for pharmaceutical companies is not engaged in the “discovery of new technological information,” it is not engaged in “research and development” that is eligible for the RCW 82.04.260 special rate.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Bauer, A.L.J. – Taxpayer objects to a letter ruling denying it eligibility for the RCW 82.04.260(3) preferential business and occupation tax (B&O) rate for non-profit entities engaging in research and development. Held: Taxpayer is not eligible for the RCW 82.04.260(3) preferential rate, and is instead properly taxable under the RCW 82.04.290(2)(a) Service and Other Activities of the B&O tax.<sup>1</sup>

### ISSUES

1. Is a nonprofit organization that conducts clinical research trials for pharmaceutical companies eligible for the RCW 82.04.260(3) preferential tax rate?
2. ...

### FINDINGS OF FACT

[Taxpayer] is a nonprofit organization focused on studies involving asthma, allergies, eczema and sinusitis. Taxpayer conducts research studies for companies that want to test experimental

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

medications, devices or treatments for asthma, allergies and other allergic diseases. Taxpayer has conducted nearly 500 FDA approved clinical trials. To do so, it advertises and recruits study candidates; prescreens, enrolls, and educates participants; and strictly monitors subjects' participation.

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On November 26, 2013, Taxpayer's Representative emailed the Taxpayer Information and Education Section (TI&E) of the Taxpayer Services Division of the Department of Revenue (Department) for a ruling, explaining that it was a "not-for-profit research and educational facility."

On December 23, 2013, TI&E replied that it did not have enough information about Taxpayer's activities to confirm that Taxpayer was eligible for a preferential tax rate. TI&E went on to explain that, in order to claim the preferential B&O tax rate provided by RCW 82.04.260(3), Taxpayer would have to establish that the income reported under that code section came from engaging in qualifying research and development activities as defined in RCW 82.63.010(18).

On January 20, 2014, Taxpayer appealed the TI&E ruling to the Department's Appeals Division, arguing that it should be allowed to continue to report at the lower rate because a significant portion of its income is derived from research to develop new drugs and explore new uses for existing drugs. Taxpayer pointed out that such new uses often required separate licensing by the Federal Food and Drug Administration.

On February 28, 2014, TI&E responded to Taxpayer's appeal by stating that Taxpayer, according to its own website, does not develop new drugs, but conducts studies for other companies that do so, and so does not qualify for the preferential rate.

## ANALYSIS

1. Eligibility for RCW 82.04.260(3) preferential B&O tax rate. RCW 82.04.260(3) provides a preferential tax rate [for non-profit businesses engaging in research and development:]

Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

Taxpayer argues:

- Conducting studies for drug sponsors is scientific research because clinical research trials are integral to the development of drugs for licensure by the FDA.
- Separating the research site's work from the pharmaceutical company's work is inappropriate because the "body" of research requires more than just the "brain" (the pharmaceutical companies) to function; it also requires the additional "organs" (like Taxpayer) to complete the work required from the FDA to obtain licensure.

- If the term “research and development” includes “exploration of a new use for an existing drug” and if the new use requires separate licensing by the FDA, then it also includes exploration of the efficacy of experimental drugs for licensure by the FDA.

In order to qualify for the RCW 82.04.260(3) preferential rate, a taxpayer must itself be engaged in “research and development.” The phrase “research and development” is not specifically defined with respect to RCW 82.04.260(3), but is defined in RCW 82.04.4452(7), which relates to the B&O tax credit for research and development spending.<sup>2</sup> The definition of “research and development” in RCW 82.63.010(18) is likewise applicable to the preferential rate in RCW 82.04.060(3) as explained below.

The fundamental objective in statutory interpretation is to ascertain and carry out the legislature’s intent. If the statute’s meaning is plain on its face, then we are to give effect to that plain meaning as an expression of legislative intent. *State v. J.M.*, 144 Wn.2d 472, 480, 28 P.3d 720, 724 (2001). Plain meaning is discerned from all that the legislature has said in the statute and related statutes which disclose legislative intent about the provision in question. *Dep’t of Ecology v. Campbell & Gwinn L.L.C.*, 146 Wn.2d 1, 11, 43 P.3d 4, 10 (2002). A court “may examine related statutes and construe them together to determine the legislative understanding of terms.” *S. Martinelli & Company, Inc. v. Dep’t of Revenue*, 80 Wn.App. 930, 912 P.2d 521 (1996). “A court may also consider the provisions of a later enactment in determining the legislative intent in a prior enactment.” *Id.*

[To see how other statutes relate to the interpretation of RCW 82.04.260(3), it is useful to review some history.] The preferential B&O rate for “nonprofit corporation and nonprofit association engaging within this state in research and development” first came into The Revenue Act on June 1, 1965.<sup>3</sup>

In 1994, the legislature enacted RCW 82.04.4452, a B&O tax credit for research and development expenditures that exceed a certain threshold. The term “research and development” was defined in RCW 82.63.010 for purposes of that tax credit.

With regard to the calculation of the credit for research and development expenditures, the Legislature used identical language in RCW 82.04.4452 to the RCW 82.04.260(3) preferential rate provision. The 1994 version of RCW 82.04.4452 stated in pertinent part:

The credit is equal to the greater of the amount of qualified research and development expenditures of a person ... multiplied by the rate of 0.515 percent in the case of a nonprofit corporation or nonprofit association engaging within this state in research and development, and .5 percent for every other person.

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<sup>2</sup> RCW 82.04.4452 provides:

(7) For the purpose of this section: . . . (c) "Qualified research and development" shall have the same meaning as in RCW 82.63.010.

<sup>3</sup>Laws of 1965 ex.s., c 173 § 6, then at a rate of 0.044 of a percent.

In 1997, the credit statute was amended to specifically reference RCW 82.04.260(3) as follows:

The credit is equal to the greater of the amount of qualified research and development expenditures of a person ... multiplied by the rate provided in RCW 82.04.260(3) in the case of a nonprofit corporation or nonprofit association engaging within this state in research and development, and the rate provided in RCW 82.04.290(2) for every other person.

In 2005, the credit statute was amended to change the calculation of the credit to the average B&O tax rate of a taxpayer, and no longer refers specifically to nonprofits or RCW 82.04.260(3).

By enacting parallel language in the 1994 version of the credit statute, and later specifically referencing RCW 82.04.260(3) in the 1997 version, the legislature intended the B&O tax credit to be construed with the preferential rate statute as part of a unified statutory scheme. The B&O tax credit for research and development expenditures of a nonprofit was calculated in relation to the amount of B&O tax paid under the preferential rate for research and development income of a nonprofit. If “a nonprofit corporation or nonprofit association engaging within this state in research and development” did not have the same meaning under both statutes, the credit calculation would not be in relation to the taxpayer’s B&O tax liability, [which would] lead to absurd results. We therefore conclude the legislature must have intended the phrase “nonprofit corporation ... engaging within this state in research and development” to have the same meaning in both statutes. Because research and development is defined for purposes of the B&O tax credit in RCW 82.63.010, we conclude that definition also is applicable to preferential rate in RCW 82.04.260(3).

We now turn to whether the taxpayer engages in research and development as it is defined in RCW 82.63.010. RCW 82.63.010(16) defines “qualified research and development” as research and development performed in one of four high technology areas. RCW 82.63.010(18) defines “research and development” as:

[A]ctivities performed to discover technological information, and technical and nonroutine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software. The term includes exploration of a new use for an existing drug, device, or biological product if the new use requires separate licensing by the federal food and drug administration under chapter 21, C.F.R., as amended. The term does not include adaptation or duplication of existing products where the products are not substantially improved by application of the technology, nor does the term include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

Although Taxpayer works for pharmaceutical companies whose business activities may meet the definition of research and development, Taxpayer’s own business activities – conducting clinical trials for those companies -- do not. Det. No. 03-0254, 23 WTD 280 (2004) (holding that conducting clinical trials for others does not constitute engaging in research and development).

The mere fact that Taxpayer renders services to research and development pharmaceutical firms does not qualify Taxpayer to report under the R&D tax classification.

TI&E was correct when it found the Taxpayer, which conducts clinical trials for pharmaceutical companies, is not engaged in the discovery of new technological information. Taxpayer is, instead, applying a methodology established by law to study, test, and evaluate for quality drugs that are being developed by others.

Because Taxpayer's activity of conducting clinical trials are not otherwise classified by the Revenue Act, we hold that they are properly taxed under the RCW 82.04.290(2)(a) Service and Other Activities tax classification.

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#### DECISION AND DISPOSITION

Taxpayer is not entitled to the RCW 82.04.260(3) preferential B&O tax rate.

Dated this 21st day of January 2015.