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Letter Ruling 02-12: Qualification as Foreign Research and Development Corporation

December 13, 2002

You request a ruling on behalf of ***** (hereinafter, "the Company"), a Delaware corporation doing business in Massachusetts. You raise several issues relative to whether the Company qualifies as a foreign research and development corporation within the meaning of General Laws chapter 63, section 42B. Specifically, you ask whether (1) the Company's principal activity in Massachusetts is research and development; (2) the Company derives more than two-thirds of its receipts assignable to Massachusetts from research and development; and (3) the Company derives more than one-third of its receipts assignable to Massachusetts from research and development of tangible personal property capable of being manufactured in Massachusetts.

STATEMENT OF FACTS

The Company is a biopharmaceutical company with three areas of focus: technology, therapeutics, and sales of pharmaceutical products. Through its technological focus, Company identifies and develops drug and diagnostic candidates for clinical development and brings new medicines to the market. The therapeutic focus entails efforts to discover disease-related genes, validating drug targets and drug leads, and developing and commercializing new drugs to treat major human illnesses. The first two focuses require extensive research and development ("R&D") activities. The purpose of performing such R&D activities is to ultimately produce pharmaceuticals - the Company's third focus - that it can manufacture and sell; such R&D activity occurs primarily in Massachusetts. The Company also earns receipts for performing R&D activities for unrelated third parties.

The Company's research and development facilities are located in Massachusetts and California; its manufacturing operations are located in California. The Company currently has 2,314 employees, of which 1,990 are currently based in Massachusetts. Sixty-nine percent (1,383) of those employees based in Massachusetts primarily perform R&D activities. Approximately 130 employees in California primarily perform R&D activities. Although the Company's principal sales offices are located outside of the Commonwealth, some sales activity does occur in Massachusetts. For the year 2002, the Company expects to have receipts of approximately \$350 million, \$150 million (43%) of which will be from sales of pharmaceuticals and \$200 million (57%) of which will be from performing R&D services. All of the Company's 2002 revenue generating R&D services were performed in Massachusetts and were performed for the purpose of bringing pharmaceuticals to market. None of the Company's 2002 pharmaceutical sales were of products manufactured in Massachusetts. None of the Company's 2002 pharmaceutical sales were made to customers in Massachusetts. The Company had a small percentage of receipts from other sources, none of which were related to business activity carried on in Massachusetts.

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DISCUSSION

A. Relevant statute and regulation

Chapter 63, section 42B is the relevant statutory provision governing foreign research and development corporation. It states as follows:

Every corporation, association or organization established, organized or chartered under laws other than those of the commonwealth, which has a usual place of business in the commonwealth and is engaged in manufacturing therein, or engaged therein in research or development of products capable of being manufactured therein, shall, for the purposes of this chapter be deemed to be a . . . a foreign research and development corporation.

A “foreign research and development corporation” is further defined in G.L. c. 63, § 42B as “. . . one whose principal activity herein is research and development *and* (emphasis added) which derives more than two thirds of its receipts assignable to the commonwealth from such activity and derives more than one third of its receipts assignable to the commonwealth from the research and development of tangible personal property capable of being manufactured in this commonwealth”.

To summarize, and as re-stated in the Department of Revenue’s Research and Development regulation, 830 CMR 64H.6.4, Company must meet three requirements to qualify as a foreign research and development corporation:

- 1) it must have a usual place of business in Massachusetts;
- 2) its principal activity in Massachusetts must be research and development; and
- 3) it must (i) derive more than two thirds of its receipts assignable to Massachusetts from research and development, and (ii) must derive more than one third of its receipts assignable to Massachusetts from the research and development of tangible personal property capable of being manufactured in Massachusetts.

See G.L. c. 63, § 42B; 830 CMR 64H.6.4(4)(c).

B. Company’s qualification as a “foreign research and development corporation”

Based on the facts as you state them, Company clearly meets the first two requirements. With respect to the first requirement, the Company has a usual place of business in Massachusetts since its research and development facilities are located in Massachusetts.

As to the second requirement, Company’s principal activity in Massachusetts is research and development. In 830 CMR 64H.6.4(2), the Department defined the phrase “research and development” as “experimental or laboratory activity that has as its ultimate goal 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.” Company’s activities in Massachusetts, through its focus on technology and therapeutics, are either to bring new medicines to market or to develop new products and services for clinicians and researchers to use in treating patients. Such activities clearly fall within the definition of research and development. Having a majority of Massachusetts based employees engaged in R&D activity, though not essential, demonstrates that a taxpayer’s principal activity in Massachusetts is R&D. In this case, Company has represented that 69% of its Massachusetts-base employees primarily perform R&D activities. Company has demonstrated that it meets the second requirement.

With respect to the third requirement, two percentage tests must be met. First, Company must derive more than two-thirds of its receipts assignable to Massachusetts from research and development. As represented by the Company, 100% of its Massachusetts assignable receipts in 2002 are from R&D. The ratio (Massachusetts assignable R&D receipts over total Massachusetts receipts) for the third requirement would, therefore, be \$200 million over \$200 million. We find that the two-thirds test is met.

The second percentage test requires that more than one-third of these receipts must be from the research and development of "tangible personal property capable of being manufactured in this Commonwealth". Similarly, neither G.L. c. 63, § 42B, nor the Research and Development regulation defines the phrase "tangible personal property capable of being manufactured in this Commonwealth." However, in interpreting the meaning of other phrases ("manufacturing corporation") in G.L. c. 63, § 42B, the Massachusetts Appellate Tax Board (ATB) has noted that "[o]ur courts have presumed that the Legislature intended to adopt the common meaning of the word with some considerations to the historical origins of the enactment." *Electronics Corp. of America v. Commissioner of Revenue* (1995) A.T.B. No. 153028, citing *First Data Corp. v. State Tax Commission*, 371 Mass. 444, 447 (1976). In interpreting the phrase "engaged in manufacturing" which also appears in G.L. c. 63, § 42B, the ATB noted that the Massachusetts Supreme Judicial Court has stated that "[f]or purposes of applying the subject statute, [this phrase] is not to be given a restrictive meaning." *Id.*, citing *Joseph T. Rossi Corp. v. State Tax Commission*, 369 Mass. 1978 (1975).

The SJC has long been mindful that "[t]he statutes granting exemption must be fairly construed and reasonably applied in order to effectuate the legislative intent and purpose to promote the general welfare of the Commonwealth by inducing new industries to locate here and to foster the expansion and development of our own industries, so that the production of goods can be stimulated, steady employment afforded to our citizens, and a large measure of prosperity sustained." *Id. at 8*, citing *Assessors of Boston v. Commissioner of Corps. & Taxation*, 323 Mass. 730, 741 (1949) (refusing to restrict definition of manufacturing corporations to those whose *principal* business is manufacturing).

Although none of the cases cited above construed the phrase "tangible personal property capable of being manufactured in this Commonwealth," we think the same interpretive principles apply to this phrase as well. In construing G.L. c. 63 in its entirety, the SJC has said "[t]he legislative intent is to be ascertained from the statute as a whole giving to every section, clause and word such force and effect as are reasonably practical to the end that, as far as possible, the statute will constitute a consistent and harmonious whole, capable of producing a rational result consonant with common sense and sound judgment. *Haines v. Town Manager of Mansfield*, 320 Mass. 140, 142. *Commissioner of Corps & Taxn. v. Springfield*, 321 Mass. 31, 36 (1947).

Thus, we begin with the notion that this phrase, like those § 42B phrases already construed by the courts, need not be restrictively interpreted. The fact that the Company's products are currently manufactured in California and that the R&D it performs for third parties may not actually result in property being manufactured in Massachusetts does not disqualify it from meeting the second test. As represented by the Company, 100% of its Massachusetts receipts in 2002 will be from R&D business activity. Company has further represented that such R&D activity is for the purpose of bringing pharmaceuticals to market. Thus, we find that the Company meets the second percentage test requiring that one-third of its receipts assignable to Massachusetts be from research and development of tangible personal property capable of being manufactured here.

CONCLUSION

As to whether the Company will qualify in 2002 as a Massachusetts Research and Development Corporation pursuant to G.L. chapter 63, § 42B, we conclude, based on the facts presented, that the company will so qualify.

Very truly yours,

/s/Alan LeBovidge

Alan LeBovidge
Commissioner of Revenue

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