

Exemption for Prototypes

Social Service Tax Act

The *Social Service Tax Act* provides an exemption for qualifying prototypes, and most materials used to make qualifying prototypes. This bulletin outlines the conditions under which this exemption applies.

The information in this bulletin is provided for your convenience and guidance and is not a replacement for the legislation. The *Social Service Tax Act* and Regulations can be found on the web at www.gov.bc.ca/sbr

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WHAT IS A PROTOTYPE?

A prototype is defined in the Act as “the first **full-scale** functional form of a new type or a new construction of tangible personal property...” but does not include software. For the purposes of this exemption, a prototype must be the result of research and development activities that are aimed at developing new or improved products or processes.

Because software is specifically excluded from this definition, a prototype of new software does not qualify for exemption. However, software developers should refer to [Bulletin SST 040, Computer Hardware, Software and Related Services](#) for exemptions that apply to this industry.

EXEMPTION FOR MATERIALS INCORPORATED INTO PROTOTYPES

Businesses that develop and manufacture their own prototypes are not required to pay tax on materials, other than certain software, that are to be attached to or processed, fabricated, manufactured or incorporated into:

- a prototype, if the prototype is a result of research and development activities aimed at developing a new or improved product or a new or improved process;

or

- a copy of the prototype, if the copy is made solely to test the prototype as part of research and development activities.

During the period May 1996 (when the exemption was introduced) to March 15, 2001, this exemption did not include any software acquired for the prototype. However, effective March 16, 2001, the exemption was expanded to include any software that is specifically designed for, and integrated into, a qualifying prototype or copy of a prototype.

General purpose software or software that may be designed for the prototype but that resides on a separate machine or computer does not qualify for this exemption.

EXEMPTION FOR PURCHASES AND LEASES OF PROTOTYPES

Effective March 16, 2001, businesses that engage the services of other businesses for the development and manufacture of a qualifying prototype are not required to pay tax on the cost of that prototype.

This exemption also applies to purchases or leases of test copies of a prototype if the prototype is made solely for the purpose of testing the prototype as a part of research and development activities.

CONDITIONS FOR EXEMPTION

Although the following refers to a prototype, the conditions also apply to eligible test copies of a prototype.

Prototypes, or materials and equipment incorporated into a prototype, retain their exempt status as long as the prototype is only used for testing, demonstration, and display purposes. If any consideration is received for use of the prototype, it must not exceed the actual cost of the demonstration. For example, consideration received to cover the actual cost of transporting the prototype and fuelling it during the demonstration will not affect the exempt status.

Prototypes, or materials and equipment incorporated into a prototype, become subject to tax on their original purchase or lease price if, at any time after the testing period, the purchaser or lessor

- becomes the user of that prototype, or
- receives any remuneration for use of the prototype that is in excess of the cost of demonstrating it.

This means that a purchaser who uses the prototype for regular production, or who undertakes a contract to use the prototype that will result in receiving consideration beyond the actual cost of demonstration, will be required to pay tax on the original cost of the prototype.

The purchaser or lessee of the prototype must maintain records supporting the use of the prototype after its manufacture. If the prototype is sold or leased after the testing period, tax must be collected and remitted by the seller or lessor on the full sale or lease price.

UNSUCCESSFUL PROTOTYPES

Where a prototype proves unsuccessful, the prototype or test copy of that prototype will retain its exempt status provided it is used by the owner in one of the following ways:

- reused to build another prototype
- discarded at owner's expense
- processed, fabricated, manufactured or incorporated into, or attached to, other tangible personal property for the purpose of a retail sale or lease, **or**
- resold to another purchaser, and tax is collected and remitted on the resale

PROTOTYPES THAT ARE IMPROVEMENTS TO REAL PROPERTY

A prototype is defined under the Act as the first full-scale functional form of **tangible personal property**. Where a new experimental item qualifies as an improvement to real property at the time of purchase, it does not meet the definition of a prototype under the Act.

Contractors providing such equipment under a lump sum contract are required to pay tax on their purchase of materials incorporated into the real property improvement because the materials are not incorporated into a prototype as defined in the legislation.

CLAIMING THE EXEMPTION

Persons who are registered as vendors or lessors under the *Social Service Tax Act* may obtain the prototype, an eligible test copy of the prototype, or materials to make a prototype, exempt of tax by providing their registration number to their supplier.

Persons who are not registered must provide their supplier with a completed *Certificate of Exemption (FIN 453)* on which the materials and equipment being purchased or leased are listed and the purpose for the purchase or lease is documented.

Sellers and lessors providing the exemption must ensure that they retain this documentation to substantiate the non-collection of tax on that sale or lease.

REFUNDS

Persons who acquired tangible personal property to which the exemption applies may submit a claim for a refund of tax paid on the purchase or lease price. Only items purchased or leased on or after the effective dates for exemption as noted in this bulletin are eligible for refunds.

The refund claim must include a description of the tangible personal property purchased or leased, copies of sales invoices or lease agreements showing the purchase or lease price and the amount of tax paid, as well as an explanation of the purpose for which the items were acquired.

NEED MORE INFO?

This bulletin is provided for convenience and guidance. If you still have questions call us at 604 660-4524 in Vancouver or toll-free at 1 877 388-4440 elsewhere in Canada or refer to the legislation.

Information is also on the web at www.gov.bc.ca/sbr While there, you can subscribe to our free electronic update service.

References: *Social Service Tax Act*, Sections 1, 9(3)-(5), 76(1)(d), 76(1)(d.1), 76(3) and Regulations 3.33, 3.34