

# Ministry of Finance

## Tax Bulletin



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Bulletin SST 109

[www.fin.gov.bc.ca/rev.htm](http://www.fin.gov.bc.ca/rev.htm)

On July 1, 2010, the provincial sales tax (PST) was replaced with the harmonized sales tax (HST). However, the information in this bulletin may still be applicable if, under the transitional rules, PST applies. For information on the transitional rules, please see [www.sbr.gov.bc.ca/business/Consumer\\_Taxes/Harmonized\\_Sales\\_Tax/hst.html](http://www.sbr.gov.bc.ca/business/Consumer_Taxes/Harmonized_Sales_Tax/hst.html)

## Prototypes

### *Social Service Tax Act*

**Do you develop prototypes to improve products and processes?**

**Do you need to know how the PST exemption for prototypes applies to your business?**

This bulletin provides specific tax information to help you understand how the social service tax, also called the provincial sales tax (PST), applies to prototypes used in your business.

For general PST information that applies to all businesses, such as who needs to register, when general exemptions apply, and how to charge and collect the PST, please read our *Small Business Guide to Provincial Sales Tax (PST)*.

## Table of Contents

Prototypes and Mock-ups.....	2
Purchases.....	3
Software .....	4
Improvements to Real Property.....	5
Claiming the Exemption .....	5
Production Machinery and Equipment (PM&E) Exemption.....	5

## Prototypes and Mock-ups

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### Prototypes

The exemption for prototypes is designed to encourage research and development in British Columbia. You may qualify for the PST exemption on prototypes if the prototype that you purchase or manufacture is:

- the first full-scale functional form of a new product, and
- the result of research and development activities aimed at developing a new or improved product, or a new or improved process.

You may also use test copies of the original prototype to test the prototype in the research and development process. The exemption for prototypes applies to test copies.

### Mock-ups

You may create a mock-up for your customer before you produce the prototype. You charge PST on mock-ups as they do not qualify for the prototype exemption.

However, under specific circumstances, a mock-up may be non-taxable. A mock-up is considered incidental and non-taxable if the main purpose of the contract is to provide a service and not to provide a tangible product. For example, if you are an engineer that produces a mock-up in the form of a scale model, the main purpose of your contract may be to provide an engineering service and not to produce a mock-up. If you are unsure of how PST applies to mock-ups, please contact us.

If you sell a taxable mock-up and a prototype for a single price, it is a bundled sale. Generally, you charge PST on the fair market value of the taxable portion (i.e. the mock-up). However, there are exceptions to this general rule. For more information, please see **Bulletin SST 119**, *Bundled Sales: Taxable and Non-Taxable Goods or Services Sold Together for a Single Price*.

## **Purchases**

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### **When Not to Pay**

#### **Materials**

You do not pay PST on materials that are attached to, processed, fabricated, manufactured or incorporated into a prototype if you develop and manufacture your own prototypes.

#### **Complete prototypes**

You do not pay PST on the purchase of a complete prototype from another business if the prototype is only used for:

- demonstration and display purposes, and/or
- testing purposes in the research and development process.

#### **Unsuccessful prototypes**

You do not pay PST on unsuccessful prototypes that you:

- reuse to build another prototype,
- discard at your own expense,
- process, fabricate, manufacture or incorporate into, or attach to, other goods for the purpose of a retail sale or lease, or
- resell.

**Please note:** You are required to charge PST on sales of prototypes that are incorporated into any taxable goods.

#### **Modified prototypes**

You do not pay PST on new components added to a prototype if the modified prototype is:

- the first full-scale functional form of a new product, and
- used only for demonstration and display purposes, and/or testing purposes in the research and development process.

If you receive a payment or other consideration to cover the actual cost of the demonstration, such as transportation costs and set-up costs, the prototype still qualifies for the exemption.

### **Test equipment attached to a prototype**

You do not pay PST if the function of that test equipment attached to a prototype is separate from the function of the original prototype. For example, you may invent test equipment and attach the test equipment to a prototype.

The test equipment attached to a prototype is non-taxable, as long as it is the first full-scale functional form of a new product in the research and development activities.

### **Electrical, mechanical, or electronic systems used with a prototype**

You do not pay PST if the system is part of the prototype. For example, a motor placed in a prototype vehicle is non-taxable as the motor is incorporated in the prototype vehicle.

In addition, materials incorporated into the motor system are non-taxable as the motor is incorporated in the prototype vehicle.

### **When to Pay**

You pay PST on prototypes, or materials and equipment incorporated into a prototype if, at any time after the testing period, you:

- become the user of that prototype, or
- receive any remuneration for use of the prototype that is in excess of the cost of the demonstration.

### **Software**

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You do not pay PST on software that is specifically designed for, and integrated into, the prototype.

You pay PST on software that is:

- not specifically designed for, and integrated into, the prototype, or
- designed for the prototype but not attached to or incorporated into the prototype.

However, if you are a software developer, you can refer to **Bulletin SST 040**, *Computer Hardware, Software and Related Services* for exemptions that apply to your business.

## **Improvements to Real Property**

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You pay PST on materials that become an improvement to real property as real property is not eligible for the prototype exemption.

For example, if a prototype is housed in a building that is attached to the prototype, and the building is real property, materials incorporated into the building do not qualify for the exemption.

For more information on improvements to real property, please see **Bulletin SST 072**, *Real Property Contractors*.

## **Claiming the Exemption**

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To purchase a prototype, an eligible test copy of the prototype, or materials to make a prototype without paying PST, give the supplier your PST registration number.

If you do not have a PST registration number, give the supplier your completed *Certificate of Exemption* form (**FIN 453**).

## **Production Machinery and Equipment (PM&E) Exemption**

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If you use a prototype on your production line, you may not qualify for the exemption for prototypes.

However, if you are a qualifying manufacturer, you may qualify for the PM&E exemption. For more information, please see **Bulletin SST 054**, *Manufacturers*.

### **Need more info?**

Toll free in Canada: 1 877 388-4440

E-mail: [CTBTaxQuestions@gov.bc.ca](mailto:CTBTaxQuestions@gov.bc.ca)

The information in this bulletin is for your convenience and guidance and is not a replacement for the legislation. The *Social Service Tax Act* and Regulations are available on our website.

# Acknowledgments

This bulletin has been prepared in consultation with industry representatives. We wish to acknowledge and thank the *Canadian Manufacturers & Exporters (BC Division)* for their input. By working with us, they help us better serve their members and work towards making British Columbia the best place to do business.

References: *Social Service Tax Act*, Sections 1, 9(3)-(5), 76(1)(d), 76(1)(d.1) and 76(3), and Regulations 3.33, 3.34 and 16.1