## STATE BOARD OF EQUALIZATION
## STAFF LEGISLATIVE BILL ANALYSIS

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| Date Amended: | **06/14/01** | Bill No: | **AB 278** |
| Tax: | **Sales and Use** | Author: | **Cohn, et al.** |
| Board Position: | | Related Bills: | |

### BILL SUMMARY

This bill would, among other things, extend to January 1, 2008, the sunset date for the 5 percent sales and use tax exemption for new manufacturers.

### ANALYSIS

#### Current Law

Existing law, Section 6377 of the Sales and Use Tax Law, provides a 5 percent sales and use tax exemption for purchases of manufacturing equipment. Under the law, this partial exemption is available only to "qualified persons," who include only new trades or businesses that are engaged in those lines of business described in Standard Industrial Codes 2000 to 3999 (manufacturers). The partial exemption applies to the following:

- Tangible personal property to be used 50 percent or more in any stage of manufacturing, processing, refining, fabricating, or recycling of property (i.e., machinery, equipment belts, shafts, computers, software, pollution control equipment, buildings and foundations).
- Tangible personal property purchased for use in research and development.
- Tangible personal property purchased by a contractor or a subcontractor for use in a construction contract for a manufacturer for use in manufacturing, processing, refining, fabricating, recycling, or as a research or storage facility.
- Tangible personal property purchased to be used 50 percent or more in maintaining, repairing, measuring, or testing any exempt manufacturing equipment.

This exemption statute contains a sunset provision based on the number of manufacturing jobs in California. Under the current provision, if the number of non-aerospace manufacturing jobs in California has not increased by at least 100,000 above the comparable 1994 number, the exemption will expire on January 1, 2001. Each year, the Employment Development Department is required to determine the number of non-aerospace manufacturing jobs, and if the number ever falls below 100,000, the exemption will expire on the next January 1.

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, a 6 percent income tax credit on similar property is available to businesses who do not qualify as a new trade or business under Section 6377. A similar sunset clause is contained in these laws as well.

### Proposed Law

This bill would, among other things, increase the manufacturer's credit contained in the Personal Income Tax Law and Bank and Corporation Tax Law from 6% to 7%, and would extend the sunset dates contained in both the income tax laws and the Sales and Use Tax Law from January 1, 2001 to January 1, 2008.

As a tax levy, the bill would become effective immediately upon enactment.

### Background

The manufacturer's sales and use tax partial exemption for new manufacturers and the corresponding income tax credit for existing manufacturers were added in 1994 by SB 671 (Stats. 1993, Ch. 881). The purpose of that legislation was to enable California to become competitive with the 42 other states that exempted manufacturing equipment and were luring manufacturers away from California with promises of lower taxes. SB 671 was designed to provide California companies with an immediate incentive to expand their facilities and to create new jobs.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by Governor Gray Davis. The one percent increase to the rate of the income tax credit allowed is seen as an important factor in California's ability to attract and retain manufacturing businesses.

2. **Will the exemption/credit ever sunset?** The sunset dates were originally drafted and continue to be worded in such a way that they would likely never be triggered - by the end of 1998, manufacturing employment has increased by about 207,000 more than in 1994. Therefore, unless the state falls into another deep recession, the statutes will likely remain in effect. The change to the sunset dates proposed by this measure would therefore not likely have a significant effect.

## COST ESTIMATE

Enactment of this measure would not impact the Board's administrative costs.

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

**REVENUE ESTIMATE**

It is anticipated that the partial exemption would have remained beyond the existing January 1, 2001 sunset date anyway, and for that reason, this measure would not affect the state's revenues.  However, as a point of reference, for calendar year 2000, the 5% exemption resulted in a General Fund Revenue loss of $1.6 million.

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