Rulemaking File

Table of Contents

Title18. Public Revenue

Sales and Use Tax

Regulation 1525.4, *Manufacturing and Research & Development Equipment*

OAL Approval

Index

1. Final Statement of Reasons
2. Updated Informative Digest
3. Business Tax Committee Minutes, April 22, 2014
4. Reporter's Transcript Business Taxes Committee, April 22, 2014
5. Estimate of Cost or Savings, January 24, 2014
6. Economic and Fiscal Impact Statements, May 20, 2014
7. Notice of Publications
8. Notice to Interested Parties, May 30, 2014
9. Statement of Compliance
10. Reporter's Transcript, Item F1, July 17, 2014
11. Draft Minutes, July 17, 2014, and Exhibits

OFFICE OF ADMINISTRATIVE LAW
300 Capitol Mall, Suite 1250
Sacramento, CA 95814
(916) 323-6225 FAX (916) 323-6826

DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk JO
DATE: 9/26/2014
RE: Return of Approved Rulemaking Materials
OAL File No. 2014-0814-01S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2014-0814-01S regarding Manufacturing and Research & Development Equipment).

If this is an approved file, it contains a copy of the regulation(s) stamped "ENDORSED APPROVED" by the Office of Administrative Law and "ENDORSED FILED" by the Secretary of State. The effective date of an approved regulation is specified on the Form 400 (see item B.5). **Beginning January 1, 2013**, unless an exemption applies, Government Code section 11343.4 states the effective date of an approved regulation is determined by the date the regulation is filed with the Secretary of State (see the date the Form 400 was stamped "ENDORSED FILED" by the Secretary of State) as follows:

(1) **January 1** if the regulation or order of repeal is filed on September 1 to November 30, inclusive.
(2) **April 1** if the regulation or order of repeal is filed on December 1 to February 29, inclusive.
(3) **July 1** if the regulation or order of repeal is filed on March 1 to May 31, inclusive.
(4) **October 1** if the regulation or order of repeal is filed on June 1 to August 31, inclusive.

If an exemption applies concerning the effective date of the regulation approved in this file, then it will be specified on the Form 400. The Notice of Approval that OAL sends to the state agency will contain the effective date of the regulation. The history note that will appear at the end of the regulation section in the California Code of Regulations will also include the regulation's effective date. Additionally, the effective date of the regulation will be noted on OAL's Web site once OAL posts the Internet Web site link to the full text of the regulation that is received from the state agency. (Gov. Code, secs. 11343 and 11344.)

Please note this new requirement: Unless an exemption applies, Government Code section 11343 now requires:

1. Section 11343(c)(1): Within 15 days of OAL filing a state agency's regulation with the Secretary of State, the state agency is required to post the regulation on its Internet Web site in an easily marked and identifiable location. The state agency shall keep the regulation posted on its Internet Web site for at least six months from the date the regulation is filed with the Secretary of State.

2. Section 11343(c)(2): Within five (5) days of posting its regulation on its Internet Web site, the state agency shall send to OAL the Internet Web site link of each regulation that the agency posts on its Internet Web site pursuant to section 11343(c)(1).

OAL has established an email address for state agencies to send the Internet Web site link to for each regulation the agency posts. Please send the Internet Web site link for each regulation posted to OAL at postedregslink@oal.ca.gov.

NOTE ABOUT EXEMPTIONS. Posting and linking requirements do not apply to emergency regulations; regulations adopted by FPPC or Conflict of Interest regulations approved by FPPC; and regulations not subject to OAL/APA review. However, an exempt agency may choose to comply with these requirements, and OAL will post the information accordingly.

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "…no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the State Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

STATE OF CALIFORNIA--OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

STD. 400 (REV. 01-2013)

For use by Secretary of State only

ENDORSED FILED IN THE OFFICE OF

2014 SEP 25 PM 2:31

DEBRA BOWEN SECRETARY OF STATE

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2014-0520-01	2014-0814-01S	

For use by Office of Administrative Law (OAL) only

2014 AUG 14 AM 11:33

OFFICE OF ADMINISTRATIVE LAW

NOTICE

REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (If any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
☐ Notice re Proposed Regulatory Action ☐ Other			

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	☐ Approved as Submitted ☐ Approved as Modified ☐ Disapproved/ Withdrawn	2014, 222	5/30/2014

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)
Manufacturing and Research & Development Equipment

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT
1525.4

AMEND

REPEAL

TITLE(S)
18

3. TYPE OF FILING

- ☒ Regular Rulemaking (Gov. Code §11346)
- ☐ Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)
- ☐ Emergency (Gov. Code, §11346.1(b))
- ☐ Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.
- ☐ Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)
- ☐ Emergency Readopt (Gov. Code, §11346.1(h))
- ☐ File & Print
- ☐ Other (Specify) _____
- ☐ Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
- ☐ Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

- ☐ Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))
- ☒ Effective on filing with Secretary of State
- ☐ §100 Changes Without Regulatory Effect
- ☐ Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

- ☐ Department of Finance (Form STD. 399) (SAM §6660)
- ☐ Fair Political Practices Commission
- ☐ State Fire Marshal
- ☐ Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
Richard E. Bennion	(916) 445-2130	(916) 324-3984	rbennion@boe.ca.gov

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE
Joann Richmond

DATE
August 14, 2014

TYPED NAME AND TITLE OF SIGNATORY
Joann Richmond, Chief, Board Proceedings Division

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

SEP 25 2014

Office of Administrative Law

Final Text of

California Code of Regulations, Title 18, Section 1525.4,

Manufacturing and Research & Development Equipment

(A new regulation to be added to the California Code of Regulations)

1525.4. Manufacturing and Research & Development Equipment.

(a) Partial Exemption for Property Purchased for Use in Manufacturing and Research and Development. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a)(1) or (2).

(4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) Definitions. For the purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation.

(4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) "Primarily" means 50 percent or more of the time.

(6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form,

including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property.

(8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are reasonably described in a qualified four digit industry group. For example, a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group. For the purpose of this subdivision:

> 1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005.
>
> A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities.
>
> A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of any one of the following to or from a qualifying line of business: (1) employee salaries and wages, (2) value of production, or (3) number of employees based on a full-time equivalency.

For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a company derives 40% of its gross revenues from qualified manufacturing activities and 40% from non-qualified manufacturing activities; but, the remaining 20% of its gross revenues are derived from qualified research and development contracts, the company would qualify because overall, 60% of the gross revenues are from qualifying activities.

Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination.

There may be more than one qualifying establishment within a legal entity.

In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

2. For purposes of this subdivision, "establishment" includes multiple or single physical locations (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712.

(B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include:

1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101.

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

(9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following:

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the qualified person or another party.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or

reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(B) "Qualified tangible personal property" does not include any of the following:

1. Consumables with a useful life of less than one year.

2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction.

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation.

(c) Partial Exemption Certificate.

(1) In General. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person.

(2) Blanket Partial Exemption Certificate. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) Form of Partial Exemption Certificate. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (7)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) Retention and Availability of Partial Exemption Certificates. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

(5) Good Faith. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3).

(d) When the Partial Exemption Does Not Apply. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business.

(2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under

subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption.

(e) Purchaser's Liability for the Payment of Sales Tax. If a purchaser certifies in writing to the seller that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

(f) Leases. Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

(g) Construction Contractors. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

(1) Partial Exemption Certificates. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a

qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e).

(2) Construction Contractors as Qualified Persons. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the $200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use.

(3) $200,000,000 Limit. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) Claim for Refund. Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6377.1, Revenue and Taxation Code.

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible property purchased or leased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- converted for use in a manner not qualifying for the exemption; **or**
- used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

Description of qualified tangible property purchased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Obtaining Copies of the Decree. Interested parties may obtain a copy of the Consent Decree by contacting Ms. Rania Zabaneh at (714) 484–5479.

Comments on the Decree. DTSC invites any interested persons to submit comments on the Consent Decree. Comments must be **received by DTSC on or before November 10, 2014.** The comments should reference the Site name and be directed to:

Rania Zabaneh
Department of Toxic Substances Control
5796 Corporate Avenue
Cypress, California 90630
Rania.Zabaneh@dtsc.ca.gov

DTSC's responses to any timely comments will be available for inspection at DTSC's office in Cypress, California.

Further information regarding this matter may be obtained by contacting any of the following persons: Deputy Attorney General Sarah Morrison at (213) 897–2640, or DTSC Attorney Ann Carroll at (916) 323–2829.

SUMMARY OF REGULATORY ACTIONS

REGULATIONS FILED WITH SECRETARY OF STATE

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653–7715. Please have the agency name and the date filed (see below) when making a request.

File# 2014–0818–01
BOARD OF EQUALIZATION
Collection of Use Tax by Retailers

In this change without a regulatory effect, the Board is amending Title 18, subdivision 1684(i) to set September 15, 2012 as the effective date for the regulations adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re–enacted by Statutes 2011, chapter 313 (Assem. Bill No. 155, section 3). It also specifies that any 2012 amendments that implement, interpret and make specific a specific use tax collection obligation that did not exist on June 27, 2011, does not have any retroactive effect.

Title 18
California Code of Regulations
AMEND: 1684
Filed 09/29/2014
Agency Contact:
Richard E. Bennion (916) 445–2130

File# 2014–0814–01
BOARD OF EQUALIZATION
Manufacturing and Research & Development Equipment

This rulemaking action by the Board of Equalization adds section 1525.4 to title 18 of the California Code of Regulations. This section implements and explains the partial exemption from sales and use tax for sales and purchases of tangible personal property for use in specified manufacturing and/or research and development activities that was established by Revenue and Taxation Code section 6377.1.

Title 18
California Code of Regulations
ADOPT: 1525.4
Filed 09/25/2014
Effective 09/25/2014
Agency Contact:
Richard E. Bennion (916) 445–2130

File# 2014–0922–04
CALIFORNIA HEALTH BENEFIT EXCHANGE
Eligibility and Enrollment Process for the Individual Exchange

This emergency action was submitted for a third re–adopt of the regulations pursuant to Government Code section 100504(a)(6). These regulations established the Health Benefit Exchange's policies and procedures for eligibility determination and redetermination, enrollment in qualified health plans, and termination of coverage through the Exchange in the individual Market. In this third re–adopt, the regulations are amended to add definitions. The amendments also expand on the procedures for annual eligibility redetermination and for termination of coverage.

Title 10
California Code of Regulations
ADOPT: 6408, 6410, 6450, 6452, 6454, 6470, 6472, 6474, 6476, 6478, 6480, 6482, 6484, 6486, 6490, 6492, 6494, 6496, 6498, 6500, 6502, 6504, 6506, 6508, 6510, 6600, 6602, 6604, 6606, 6608, 6610, 6612, 6614, 6616, 6618, 6620
Filed 09/30/2014
Effective 09/30/2014
Agency Contact: Bahara Hosseini (916) 228–8486

Rulemaking File Index

Title 18. Public Revenue

Sales and Use Tax

Regulation 1525.4, *Manufacturing and Research & Development Equipment*

1. Final Statement of Reasons

2. Updated Informative Digest

3. Business Tax Committee Minutes, April 22, 2014

   - Minutes
   - Deputy Director memo dated April 11, 2014
   - BTC Agenda
   - Formal Issue Paper Number 14-001
   - Exhibit 1 Revenue Estimate
   - Exhibit 2 Text Regulation 1525.4
   - Exhibit 3 Submission from CalTax
   - Exhibit 4 Submission from Waste Management
   - Exhibit 5 Submission from Qualcomm
   - Exhibit 6 Submission from Downey-Smith & Fier
   - Exhibit 7 Submission from UCLA
   - Exhibit 8 Submission from Oakley, Inc.
   - Exhibit 9 Submission from California Poultry Federation

4. Reporter's Transcript Business Taxes Committee, April 22, 2014

5. Estimate of Cost or Savings, January 24, 2014

6. Economic and Fiscal Impact Statements, May 20, 2014

7. Notice of Publications

   - Form 400 and Notice, Publication Date May 30, 2014
   - Email sent to Interested Parties, May 30, 2014
   - CA Regulatory Notice Register 2014, Volume No. 22-Z

8. Notice to Interested Parties, May 30, 2014

   The following items are exhibited:

   - Notice of Hearing
   - Initial Statement of Reasons
   - Proposed Text of Regulation 1525.4
   - Regulation History

9. Statement of Compliance

10. Reporter's Transcript, Item F1, July 17, 2014

11. Draft Minutes, July 17, 2014, and Exhibits

    - Notice of Proposed Regulatory Action
    - Initial Statement of Reasons
    - Proposed Text of Regulation 1525.4
    - Regulation History

VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on August 14, 2014 and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

August 14, 2014

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

Final Statement of Reasons for the Adoption of California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

Update of Information in the Initial Statement of Reasons

On July 17, 2014, the State Board of Equalization (Board) held a public hearing regarding the proposed adoption of California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment.* During the public hearing, the Board unanimously voted (Board Member Steel absent) to adopt proposed Regulation 1525.4 without making any changes.

The factual basis, specific purposes, and necessity for, the problems to be addressed by, and the anticipated benefits from the adoption of proposed Regulation 1525.4 are the same as provided in the initial statement of reasons.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by Revenue and Taxation Code (RTC) section 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The adoption of proposed Regulation 1525.4 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to proposed Regulation 1525.4.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting Regulation 1525.4 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business, the Board's determination that the proposed regulatory action is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, and the Board's economic impact assessment, which determined that the Board's proposed regulatory action:

- Will neither create nor eliminate jobs in the State of California;
- Nor result in the elimination of existing businesses;
- Nor create or expand business in the State of California; and
- Will not regulate or affect the benefits of the regulation to the health and welfare of California residents, worker safety, or the state's environment.

The adoption of proposed Regulation 1525.4 may affect small businesses.

Necessity for Duplication

Proposed Regulation 1525.4 duplicates some of the provisions in RTC section 6377.1, which is cited in the regulation's "reference" note, and the duplication is necessary to satisfy the "clarity" standard of Government Code section 11349.1, subdivision (a)(3), by providing those subject to the regulation with all the relevant statutory requirements in one place.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of proposed Regulation 1525.4 does not impose a mandate on local agencies or school districts.

Public Comments

The Board did not receive any written comments regarding the proposed regulatory action. During the July 17, 2014, public hearing, Therese Twomey, Fiscal Policy Director for the California Taxpayers Association (CalTax), thanked the Board and the Board's staff for its leadership and work in drafting proposed Regulation 1525.4 in a manner consistent with the economic growth envisioned by the legislature, and offered support in favor of adopting proposed Regulation 1525.4. The Board considered Therese Twomey's comments prior to the adoption of proposed Regulation 1525.4. Therese Twomey was the only interested party that appeared at the public hearing on July 17, 2014, to comment on the proposed regulatory action.

Determinations Regarding Alternatives

By its motion on July 17, 2014, the Board determined that no alternative to the adoption of proposed Regulation 1525.4 would be more effective in carrying out the purposes for which the regulatory action is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or provisions of law.

The Board did not reject any reasonable alternative to proposed Regulation 1525.4 that would lessen any adverse impact the proposed regulatory action may have on small business.

No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

Request for Early Effective Date

The Board has adopted proposed Regulation 1525.4 to implement, interpret, and make specific the partial exemption from sales and use tax provided by RTC section 6377.1, effective on July 1, 2014, and, once the regulation is effective, its provisions will have a retroactive effect to July 1, 2014, pursuant to RTC section 7051. Therefore, the Board has determined that there is good cause to request an early effective date for Regulation 1525.4 in order to ensure that the regulation is effective as soon possible, and the Board hereby requests that Regulation 1525.4 be effective immediately upon filing with the Secretary of State, pursuant to Government Code section 11343.4, subdivision (b)(3).

Updated Informative Digest for the State Board of Equalization's Adoption of California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

On July 17, 2014, the State Board of Equalization (Board) held a public hearing regarding the proposed adoption of California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment.* During the public hearing, the Board unanimously voted (Board Member Steel absent) to adopt proposed Regulation 1525.4 without making any changes.

The Board did not receive any written public comments regarding the proposed regulatory action. During the July 17, 2014, public hearing, Therese Twomey, Fiscal Policy Director for the California Taxpayers Association (CalTax), thanked the Board and the Board's staff for its leadership and work in drafting proposed Regulation 1525.4 in a manner consistent with the economic growth envisioned by the legislature, and offered support in favor of adopting proposed Regulation 1525.4. The Board considered Therese Twomey's comments prior to the adoption of proposed Regulation 1525.4. Therese Twomey was the only interested party that appeared at the public hearing on July 17, 2014, to comment on the proposed regulatory action.

There have not been any changes to the applicable laws or the effect of, the objectives of, and anticipated benefits from the adoption of proposed Regulation 1525.4 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulatory action provides:

> Summary of Existing Laws and Regulations
>
> As a general matter, California's Sales and Use Tax Law (RTC, div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)
>
> When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes

sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;
- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and

before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:
> (i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.
> (ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. Regulation 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by

its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the circumstances under which a

seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section

6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Effect, Objectives, and Benefits of the Proposed Adoption of Regulation 1525.4

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the

application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1. Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types

of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3). Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);

- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1, subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations.

And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a

partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's

Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons

and construction contractors must issue to retailers, and providing sample partial exemption certificates that meet the required form for such persons to use;

- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The Board has performed an evaluation of whether proposed Regulation 1525.4 is inconsistent or incompatible with existing state regulations and determined that the proposed regulation is not inconsistent or incompatible with existing state regulations. This is because proposed Regulation 1525.4 is the only state regulation that specifically implements, interprets, and makes specific the provisions of RTC section 6377.1, prescribes the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute, and explains when such a certificate is taken timely and in good faith. Proposed Regulation 1525.4 is consistent with Regulation 1521, which contains the general provisions applicable to transactions involving construction contracts, and Regulation 1660, which contains the general provisions applicable to lease transactions. And, the Board reviewed Regulations 1525.2 and 1532 in detail, and specifically made proposed Regulation 1525.4 consistent with Regulations 1525.2 and 1532 to the extent that those regulations contained provisions that were appropriate for implementing the new partial exemption and consistent with RTC section 6377.1. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulation 1525.4.

BOARD OF EQUALIZATION
BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE MICHELLE STEEL, COMMITTEE CHAIR
450 N STREET, SACRAMENTO
MEETING DATE: APRIL 22, 2014, TIME: 10:00 A.M.

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

Title: Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment.*

Issue:

Whether the Board should approve proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*, in order to implement and explain the partial exemption from sales and use tax for sales and purchases of tangible personal property for use in specified manufacturing and/or research and development activities that was established by Revenue and Taxation Code section 6377.1.

Committee Discussion:

Staff introduced Regulation 1525.4 explaining the areas of disagreement with interested parties. Ms. Therese Twomey representing CalTax thanked the Board for their leadership on this issue and explained that they agree with staff's proposed regulation except for the definition of "primarily engaged" presented in Action 3 discussed below (Alternative 3 in the issue paper). Mr. Joe Vinatieri addressed the Board and thanked staff and interested parties for working cooperatively during the Interested Parties process. Mr. Vinatieri asked the Board to provide a process to encourage taxpayers to obtain a written opinion that would qualify for Section 6596 relief regarding whether a transaction qualifies for the partial exemption. Staff explained that this information is provided on the BOE Manufacturer's Exemption webpage and in the Special Notice and other information provided to taxpayers. Ms. Nichole Rice from the California Manufacturers and Technology Association thanked staff and is encouraged that the new exemption will increase manufacturers' investment in California.

Mr. Bill Mattos representing the California Poultry Federation and Brian Grant from Foster Farms asked that the Board consider additional revisions to Regulation 1525.4 to provide guidance that would allow their industry to qualify for the partial exemption. Staff explained that Section 6377.1 specifically excludes a trade or business that is required to apportion its business income pursuant to RTC section 21528 (b) which includes agricultural business activity. Mr. Horton asked staff to bring the issue to the Board's Legislative Committee at the May meeting and asked staff to work with the industry to come up with a legislative solution to resolve this issue. The Members also encouraged Mr. Mattos and Mr. Grant to work directly with the Legislature to expedite a resolution.

Mr. Chuck White from Waste Management and Mr. Ralph Chandler from the California Refuse and Recycling Council asked the Board to clarify the definition of a qualified person for the recycling industry. They explained that they support staff's recommendation except for the language presented in Action 2 discussed below (Alternative 2 in the issue paper).

first quarter 2014 return. Ms. Steel inquired as to what type of outreach was made to the retailers who did not file the additional reimbursement. Staff responded that it sends special notices and email blasts to the lumber accounts.

Mr. Ken Dunham, of the West Coast Lumber Building Materials Association, noted there has been some progress in determining the number of locations eligible for the reimbursement. Mr. Dunham explained that he thought the number of businesses entities filing lumber assessment returns would eventually be close to 3,000. Mr. Dunham also reiterated the industry's prior request for reimbursement of costs of $5,500.

Mr. Runner asked staff if there was sufficient data to warrant consideration of increasing the reimbursement amount. Staff expressed its concern regarding retailers who had not claimed any amount or did not claim their full reimbursement. Staff explained it may have a better idea following the filing of the first quarter 2014 returns. Staff welcomed any guidance as to whether outreach should be made to retailers who have reported lumber sales but still have not claimed any reimbursement. Mr. Runner noted that it would be helpful if staff came back with an update after receiving the first quarter 2014 returns.

Ms. Yee asked if Administrative Costs were expected to change. Staff stated that if the reimbursement amounts remained unchanged, it would expect the administrative costs to decrease slightly and if the reimbursement amounts were to change the administrative costs would stay the same due to programming costs. Ms. Yee reiterated the fund anticipated revenue of $30 million from the fee. Ms. Yee requested that staff provide the Legislature an update on the lumber assessment. Staff responded that it would work with the Legislative and Research Division in regards to an update.

Committee Direction:

The Committee directed staff to compile first quarter 2014 return information and provide an update at the July 2014 Board Meeting. The Committee also directed staff to inform the Legislature of the progress of the lumber assessment.

Honorable Michelle Steel, Committee Chair

Cynthia Bridges, Executive Director

BOARD APPROVED
at the 5/22/14 Board Meeting

Joann Richmond, Chief
Board Proceedings Division

Regulation 1525.4, *Manufacturing and Research & Development Equipment*
Reference: Section 6377.1, Revenue and Taxation Code

(a) PARTIAL EXEMPTION FOR PROPERTY PURCHASED FOR USE IN MANUFACTURING AND RESEARCH AND DEVELOPMENT. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections, 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a) (1) or (2).

(4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) DEFINITIONS. For the purposes of this regulation:

***

(1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation.

(4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) "Primarily" means 50 percent or more of the time.

(6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form, including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property.

(8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American

***

Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are reasonably described in a qualified four digit industry group. For example, a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group. For the purpose of this subdivision:

1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005.

A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities.

A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of either of the following to a qualifying line of business: (1) employee salaries and wages, (2) value of production, or (3) number of employees based on a full-time equivalency.

For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a company derives 40% of its gross receipts from qualified manufacturing activities and 40% from non-qualified manufacturing activities; but, the remaining 20% of its gross receipts are derived from qualified research and development contracts, the company would qualify because overall, 60% of the gross receipts are from qualifying activities.

Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination.

There may be more than one qualifying establishment within a legal entity.

In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

***

The proposed regulation contained in this document may not be adopted. Any version that is adopted may differ from this text.

2. For purposes of this subdivision, "establishment" includes multiple or single physical locations, (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712.

(B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include:

1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101.

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

(9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following:

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or

***

more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the qualified person or another party.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an

integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(B) "Qualified tangible personal property" does not include any of the following:

1. Consumables with a useful life of less than one year.

2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction.

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation.

(c) PARTIAL EXEMPTION CERTIFICATE.

(1) IN GENERAL. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time

***

before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person.

(2) BLANKET PARTIAL EXEMPTION CERTIFICATE. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption

***

certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) FORM OF PARTIAL EXEMPTION CERTIFICATE. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (7)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) RETENTION AND AVAILABILITY OF PARTIAL EXEMPTION CERTIFICATES. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

***

(5) GOOD FAITH. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3).

(d) WHEN THE PARTIAL EXEMPTION DOES NOT APPLY. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business.

(2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption.

(e) PURCHASER'S LIABILITY FOR THE PAYMENT OF SALES TAX. If a purchaser certifies in writing to the seller that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

***

(f) LEASES. Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

(g) CONSTRUCTION CONTRACTORS. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

(1) PARTIAL EXEMPTION CERTIFICATES. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e).

(2) CONSTRUCTION CONTRACTORS AS QUALIFIED PERSONS. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the

***

$200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use.

(3) $200,000,000 LIMIT. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) CLAIM FOR REFUND. Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

***

The proposed regulation contained in this document may not be adopted. Any version that is adopted may differ from this text.

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible property purchased or leased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- converted for use in a manner not qualifying for the exemption; **or**
- used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

***

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

Description of qualified tangible property purchased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

***

The proposed regulation contained in this document may not be adopted. Any version that is adopted may differ from this text.

STATE OF CALIFORNIA
STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0043
1-916-324-1825 • FAX 1-916-322-4530
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (Ret.)
Second District, Lancaster

MICHELLE STEEL
Third District, Orange County

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

April 11, 2014

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the April 22, 2014 Business Taxes Committee meeting. This meeting will address the proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment.*

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m.** on **April 22, 2014** in Room 121 at the address shown above.

Sincerely,

Susanne Buehler

Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB:lw

Enclosures

cc: (all with enclosures)
Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC:71)
Senator George Runner (Ret.), Member, Second District (via email)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)
Mr. David Hunter, Board Member's Office, Fourth District
Mr. Jaclyn Appleby, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District

Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Yvette Stowers, Board Member's Office, First District
Mr. Ramon Salazar, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Mr. Alan Giorgi, Board Member's Office, Second District
Ms. Lynne Kinst, Board Member's Office, Second District
Ms. Tanya Vandrick, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges (MIC:73)
Mr. Randy Ferris (MIC:83)
Mr. Jeffrey L. McGuire (MIC:43)
Mr. Robert Tucker (MIC:82)
Mr. Bradley Heller (MIC:82)
Mr. Andrew Kwee (MIC: 82)
Mr. Lawrence Mendel (MIC: 82)
Mr. Bradley Miller (MIC:92)
Ms. Kirsten Stark (MIC:50)
Ms. Lynn Whitaker (MIC: 50)
Mr. Michael Patno (MIC: 50)
Ms. Trista Gonzalez (MIC: 44)
Mr. Jason Parker (MIC: 44)
Ms. Tracy McCrite (MIC: 44)
Mr. Robert Prasad (MIC: 44)

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action 1 — Agreed Upon Items Agenda, pages 2-17	Approve and authorize publication of proposed Regulation 1525.4 (except as indicated in Actions 2 - 3) as agreed upon by interested parties and staff.
Action 2 — Definition of Qualified Person - 1525.4 (b)(8)(A) Agenda, page 18	Approve and authorize publication of: Staff's recommendation which clarifies that a person will not be precluded from the definition of "qualified person" when there is no six digit NAICS code to describe their line of business, provided their business activities are described in a qualified four digit industry group. **OR** Recommendation from Waste Management which clarifies that a person will not be precluded from the definition of "qualified person" when there is no six digit NAICS code to describe their line of business, provided their activities or products are described in a qualified four digit industry group. This recommendation also includes an example specific to the recycling industry.
Action 3 — Defining "primarily engaged" 1525.4 (b)(8)(A) 1. Paragraph 3 Agenda, page 19	Approve and authorize publication of: Staff's recommendation which tests "primarily engaged" based on revenues or operating expenses of the entity or establishment. In addition, staff's recommendation provides that an establishment may qualify if they are primarily engaged based on employee salaries/wages or value of production. **OR** Recommendation from CalTax which tests "primarily engaged" based on revenues or operating expenses of the entity or establishment. In addition, CalTax's recommendation provides that an establishment may qualify if they are primarily engaged based on number of employees, employee hours, employee salaries/wages, number of units produced, value of production, or capital investment.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
Action 1 — Agreed Upon Items	**Regulation 1525.4, *Manufacturing and Research & Development Equipment*** **(a) PARTIAL EXEMPTION FOR PROPERTY PURCHASED FOR USE IN MANUFACTURING AND RESEARCH AND DEVELOPMENT.** Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation. For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875 percent). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution. For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375 percent). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections, 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution. Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items: (1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required. (2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a) (1) or (2). (4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes. **(b) DEFINITIONS.** For the purposes of this regulation: (1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner. (2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions. (3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation. (4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	(5) "Primarily" means 50 percent or more of the time. (6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form, including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process. (7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property. (8) (A) "Qualified person" **[See Action 2, page 18]** 1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005. A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in, a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities. **[See Action 3, page 19]** For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	and from qualified research and development lines of business. For example, if a company derives 40 percent of its gross receipts from qualified manufacturing activities and 40 percent from non-qualified manufacturing activities; but the remaining 20 percent of its gross receipts are derived from qualified research and development contracts, the company would qualify because overall, 60 percent of the gross receipts are from qualifying activities. Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination. There may be more than one qualifying establishment within a legal entity. In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business. In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used. 2. For purposes of this subdivision, "establishment" includes multiple or single physical locations (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code. 3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712. (B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include: 1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128. 2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101. In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128. (9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following: 1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13). 2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the qualified person or another party. 3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased. 4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining,

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision: a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a). b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose. c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose. d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision. e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form. f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing. (B) "Qualified tangible personal property" does not include any of the following: 1. Consumables with a useful life of less than one year. 2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction. 3. Tangible personal property used primarily in administration, general management, or marketing. (10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste. (11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product. (12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product. (13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation. **(c) PARTIAL EXEMPTION CERTIFICATE.** (1) IN GENERAL. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser. On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased. If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h). The exemption certificate form set forth in Appendix A may be used as an exemption certificate. Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3)

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person. (2) BLANKET PARTIAL EXEMPTION CERTIFICATE. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In the absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision. When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate. If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate. (3) FORM OF PARTIAL EXEMPTION CERTIFICATE. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements: (A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser. (B) The name, address and telephone number of the purchaser. (C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number. (D) A statement that the property purchased is: 1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or 2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4). (E) A statement that the purchaser is: 1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or 2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition). (F) A statement that the property purchased is qualified tangible personal property as described in subdivision (b)(9)(A). (G) A description of property purchased. (H) The date of execution of the document. (4) RETENTION AND AVAILABILITY OF PARTIAL EXEMPTION CERTIFICATES. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate. (5) GOOD FAITH. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3). **(d) WHEN THE PARTIAL EXEMPTION DOES NOT APPLY.** The exemption provided by this regulation shall not apply to either of the following: (1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year. For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business. (2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption. **(e) PURCHASER'S LIABILITY FOR THE PAYMENT OF SALES TAX.** If a purchaser certifies in writing to the seller

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale. **(f) LEASES.** Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation. For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply. **(g) CONSTRUCTION CONTRACTORS.** The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts. (1) PARTIAL EXEMPTION CERTIFICATES. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff
	business in this state for use in the performance of a qualifying construction contract for a qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B). If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e). (2) CONSTRUCTION CONTRACTORS AS QUALIFIED PERSONS. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the $200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use. (3) $200,000,000 LIMIT. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor. **(h) CLAIM FOR REFUND.** Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

_____
SELLER'S/LESSOR'S NAME

_____
SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

_____

_____

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible personal property purchased or leased[1]:

_____

_____

_____

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- the property is converted for use in a manner not qualifying for the exemption; **or**
- the property used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."
[2] Published by the US Office of Management and Budget, 2012 edition.

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME
SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Proposed Regulation 1525.4 as agreed upon by interested parties and staff

facility for use in connection with those processes.

Description of qualified tangible property purchased[1]:

_____

_____

_____

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."
[2] Published by the US Office of Management and Budget, 2012 edition.

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Alternative 1 - Staff Recommendation	Alternative 2 – Regulatory Language Proposed by Waste Management	Alternative 3 – Regulatory Languag Proposed by CalTax
Action 2 — Definition of Qualified Person 1525.4 (b)(8)(A)	(b) (8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are described in a qualified four digit industry group. For the purpose of this subdivision:	(b) (8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. For purposes of this subdivision, with respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" for not having a specific six digit NAICS code, provided that their activities or products are described in a qualified four digit industry group. For example, the recycling industry will not be precluded from the definition of a "qualified person" for not having a specific four or six digit NAICS code, provided that their activities and/or products are described in a qualified four digit industry group. For the purpose of this subdivision:	[No alternative language provided for this section.]

AGENDA — April 22, 2014 Business Taxes Committee Meeting

Manufacturing and Research & Development Equipment

Action Item	Alternative 1 - Staff Recommendation	Alternative 2 – Regulatory Language Proposed by Waste Management	Alternative 3 – Regulatory Language Proposed by CalTax
Action 3 — Defining "primarily engaged" 1525.4 (b)(8)(A) 1.	(b)(8)(A) 1. *[beginning paragraph 3]* A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of either of the following to/from a qualifying line of business: (1) Employee salaries and wages, or (2) Value of production.	[No alternative language provided for this section.]	(b)(8)(A) 1. *[beginning paragraph 3]* A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of any of the following to a qualifying line of business, as measured by: (1) Number of employees; (2) Employee hours; (3) Employee salaries and wages; (4) Number of units produced; (5) Value of production; or (6) Capital investment. For example, an establishment is a qualified person primarily engaged in a qualifying line of business if the number of employees allocated to research and development constitute 50 percent or more of the employees at that establishment.

Issue Paper Number **14-001**

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*

I. Issue

Whether the Board should approve proposed Sales and Use Tax Regulation 1525.4, *Manufacturing and Research & Development Equipment*, to implement and explain the partial exemption from sales and use tax for sales and purchases of tangible personal property for use in specified manufacturing and/or research and development activities that was established by Revenue and Taxation Code (RTC) section 6377.1.

II. Alternative 1 – Staff Recommendation

Staff recommends approval of proposed Regulation 1525.4 to clarify RTC section 6377.1, as provided in Exhibit 2. Staff's proposal defines terms, explains when the partial exemption does and does not apply, and provides sample partial exemption certificates to claim the exemption.

III. Other Alternatives Considered

Comments in response to staff's third discussion paper were received from the California Taxpayers Association (CalTax); Waste Management; Qualcomm; Downey, Smith & Fier (DSF); the University of California, Los Angeles (UCLA); Oakley, Inc.; and the California Poultry Federation. (See Exhibits 3-9.) Submissions that included suggested revisions to staff's proposed language that staff did not include in its recommendation are presented as Alternatives 2 and 3.

Alternative 2 – Waste Management Recommendation

Waste Management recommends that the definition of "qualified person" not preclude the recycling industry from qualifying for the partial exemption when the business does not have a specific four or six digit North American Industry Classification System (NAICS) code, provided that their activities and/or products are described in a qualified four digit industry group. (See pages 3-4 for a discussion of this issue; see also, Exhibit 4 and Agenda, Action Item 2.)

Alternative 3 – CalTax Recommendation

CalTax recommends that with respect to an establishment, the test for determining whether a qualified person is "primarily engaged" should include more alternatives than the staff recommendation. (See pages 4-6 for a discussion of these issues; see also Exhibit 3 and Agenda, Action Item 3.)

IV. Background

General

Created by Assembly Bill 93 (AB 93) (Stats. 2013, Ch. 69), as amended by Senate Bill 90 (SB 90) (Stats. 2013, Ch. 70), RTC section 6377.1 provides a partial exemption from sales and use tax on certain manufacturing, and research and development, equipment sales and purchases. The partial exemption applies to qualifying sales and purchases made on or after July 1, 2014, and before July 1, 2022.

The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district taxes. RTC section 6377.1 exempts certain transactions from the state general fund taxes imposed by RTC sections 6051[1], 6051.3, 6201[2], and 6201.3, and the State's Education Protection Account tax imposed by Section 36, Article XIII of the State Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption will be 4.1875 percent. After the Education Protection Account tax expires on December 31, 2016, the partial exemption will be 3.9375 percent from January 1, 2017, to June 30, 2022.

If the Education Protection Account tax is extended, or there is any other tax rate change in the RTC sections covered by the exemption, staff will amend any references to the partial exemption rate in Regulation 1525.4 accordingly. Changes of this type are generally processed as Rule 100 revisions[3].

Prior partial exemption for manufacturing equipment

RTC section 6377.1 is substantially modeled after the prior partial exemption for manufacturing equipment provided by RTC section 6377 and interpreted in Regulation 1525.2, *Manufacturing Equipment*. Under the prior program, from January 1, 1994, to December 31, 2003, new manufacturers could qualify for a partial exemption from sales and use tax on purchases of certain manufacturing equipment. The law also provided manufacturers income tax credits of 6 percent for similar equipment placed in service in California. The partial exemption and credit related to equipment used primarily for manufacturing, refining, processing, fabricating, or recycling. New manufacturers could claim the partial sales and use tax exemption or the Manufacturers' Investment Credit (MIC). However, existing manufacturers could only claim the MIC.

V. Discussion

Staff believes the intent of RTC section 6377.1 is to promote economic growth in California and has drafted proposed Regulation 1525.4 with this in mind. In general, to qualify for the partial exemption, the purchase must be for use by a qualified person, the item purchased must be qualified tangible personal property, and the use must be for a qualifying purpose. Proposed Regulation 1525.4 further defines terms in the statute, explains when the partial exemption does and does not apply, and provides sample partial exemption certificates to claim the exemption. Many of the provisions in the proposed draft are based on suggestions from interested parties during the interested parties process.

---

[1] Except for the taxes deposited pursuant to RTC section 6051.15.

[2] Except for the taxes deposited pursuant to RTC section 6201.15.

[3] California Code of Regulations, Title 1, section (Rule) 100 allows an agency to add to, revise or delete regulatory text without the regular rulemaking procedures when the revision is a "change without regulatory effect." These changes include making regulatory provisions consistent with a changed California statute when the regulatory provision is inconsistent with and superseded by the changed statute, and the adopting agency has no discretion to adopt a change which differs in substance from the one chosen. Revisions to make the partial exemption rate consistent with a changed statute would fall into this category.

The discussion below includes key issues that have changed since the last discussion paper or were raised in the final submissions from interested parties.

Definition of Qualified Person - Qualifying NAICS Codes

The partial exemption under RTC section 6377.1 is limited to persons primarily engaged in the lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the NAICS published by the US Office of Management and Budget (OMB), 2012 edition.

The NAICS was developed under the direction and guidance of the OMB as the standard for use by Federal statistical agencies in classifying business establishments for the collection, tabulation, presentation, and analysis of statistical data describing the US economy. NAICS replaced the Standard Industrial Classification (SIC) system in 1997. According to the US Census Bureau's website, there is no central government agency with the role of assigning, monitoring, or approving NAICS codes for establishments. The Census Bureau assigns one NAICS code to each establishment based on its primary activity (generally the activity that generates the most revenue for the establishment) to collect, tabulate, analyze, and disseminate statistical data describing the economy of the United States. NAICS is a two through six digit hierarchical classification system, offering five levels of detail. Each digit in the code is part of a series of progressively narrower categories and the more digits in the code signify greater classification detail. The first two digits designate the economic sector, the third digit designates the subsector, the fourth digit designates the industry group, the fifth digit designates the NAICS industry, and the sixth digit designates the national industry.

The Census Bureau provides a search feature on their website at www.census.gov/naics that allows users to search for a NAICS code by keyword or code number. Businesses can also call or email the Census Bureau for assistance in determining their code. Various other government agencies, trade associations, and regulation boards adopted the NAICS classification system to assign codes to their own lists of establishments for their own programmatic needs. Generally, codes are derived from information that the business establishment has provided on surveys, forms or administrative records. For example, when a taxpayer registering with BOE does not know their NAICS code, they enter information about their type of business and then select a NAICS code from a list of codes generated by BOE's registration system.

RTC section 6377.1 provides that the partial exemption applies to purchases of qualified tangible personal property for use by a qualified person to be used primarily in research and development, or in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property. One of the requirements is that the purchaser must be considered a qualified person in order for the partial exemption to apply.

In their submission (Exhibit 4), Waste Management points out that the legislature distinguished between four and six digit codes in RTC section 6377.1. The statute invokes the four digit NAICS codes for manufacturing, but the full six digit codes for research and development. Waste Management explains that recycling does not have a unique four digit NAICS industry group. Rather, recycling generally falls under the four digit code of the raw material being recycled. Waste Management operates facilities that processes various waste streams into raw materials which are then sold to other manufacturers. For example, glass is received by Waste Management, then sorted, crushed, sized, cleaned and processed into an intermediate product that is sold to other manufacturers for further processing. Waste Management suggests the following underlined text be added to the proposed definition of "qualified person" to clarify the proper use of the NAICS codes for a qualified taxpayer performing recycling activities:

> "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. For purposes of this subdivision, with respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" for not having a specific six digit NAICS code, provided that their activities or products are described in a qualified four digit industry group. For example, the recycling industry will not be precluded from the definition of a "qualified person" for not having a specific four or six digit NAICS code, provided that their activities and/or products are described in a qualified four digit industry group.

Staff included much of the suggested first sentence in the staff recommendation, but not the second sentence. With regard to the first sentence, staff believes it is the *activities* of the business that qualify a person and deleted "or products" from the phrase, "...provided that their activities ~~or products~~ are described in qualified four digit industry group..." to reflect that belief. With regard to the second sentence, staff believes the example could be confusing because some recyclers may not be in a qualifying NAICS. Based on discussions with staff at the Census Bureau, staff believes that some recyclers fall under NAICS code 562920 for material recovery facilities.

In discussions after their submission was sent, Waste Management expressed their disagreement with the information staff received from the Census Bureau explaining that the four digit code, "5629 - Other Waste Management Services," does not apply to recyclers. More importantly, the description for "562920 - Material Recovery Facilities" provided in the NAICS codes does not contemplate the further processing many recyclers perform prior to reselling the recycled material. While NAICS code 5629 may apply to the overall enterprise, it would not necessarily apply to an establishment which is processing recycled material for sale. Waste Management believes it was the intent of the Legislature to include within the definition of "qualified person" recyclers who are performing qualified manufacturing activities.

Definition of Qualified Person – Primarily Engaged

RTC section 6377.1 (b)(6)(A) provides that "qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the NAICS. The definition of a qualified person is further interpreted and clarified in proposed Regulation 1525.4 (b)(8)(A).

Under the prior partial exemption for manufacturing equipment, qualified taxpayers were required to be engaged in the manufacturing lines of business described in specified SIC codes. RTC section 6377.1 is broader as it includes specified research and development activities (NAICS codes 541711, or 541712); however, the section is narrower in that it requires the person be *primarily* engaged in those lines of business described in NAICS codes 3111 to 3399, 541711, or 541712. The primarily engaged requirement is also found in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment.*

Also modeled after Regulation 1525.2, Regulation 1532 provides a partial exemption for purchases of qualified equipment that will be used by a qualified person primarily engaged in teleproduction or other postproduction services. When Regulation 1532 was drafted, staff initially interpreted the term "qualified person" to mean the entire entity (e.g., a corporation) and that the entire entity must be primarily engaged in teleproduction or other postproduction activities in order to qualify for the partial

exemption. However, as the drafting of the regulation progressed, a more liberal interpretation was adopted to be consistent with Regulation 1525.2 and staff applied the primarily engaged test based on establishments within the entity.

Looking at Regulations 1525.2 and 1532 for guidance, and in response to comments from interested parties, staff's recommendation includes a two pronged test to determine whether a qualified person is "primarily engaged." First, a qualified person may meet the primarily engaged requirement based on their legal entity. That is, the person will be considered primarily engaged if in the prior financial year, the entity derived 50 percent or more of gross revenue from, or expended 50 percent or more of operating expenses in, a line of business described in the specified NAICS codes. If the qualified person does not meet the entity test, they may still be considered primarily engaged in a qualified line of business based on an establishment(s) within the entity.

Staff recommends that a person be considered "primarily engaged" as an establishment if, in the prior financial year, the establishment derived 50 percent or more of gross revenue from, or expended 50 percent or more of operating expenses in, a qualifying line of business. Alternatively, an establishment is primarily engaged if it allocated, assigned or derived 50 percent or more of either (1) employee salaries/wages, or (2) value of production to/from a qualifying line of business. CalTax, however, recommends additional criteria to determine whether an establishment is primarily engaged in a qualifying line of business.

As described in Alternative 3, CalTax recommends that in addition to the 50 percent tests based on either gross revenue or operating expenses, an establishment may be considered primarily engaged if in the prior year it allocated, assigned or derived 50 percent or more of any one of the following items to/from a qualifying line of business: (1) number of employees, (2) employee hours, (3) employee salaries/wages, (4) number of units produced, (5) value of production, or (6) capital investment[4]. In subsequent discussion, CalTax explained that these additional criteria allow qualified persons to meet the primarily engaged test when they would be wrongly eliminated based on the gross revenue or operating expense tests. For example, an establishment that would normally meet the operating expense test may not qualify because of unusual expenses attributed to a costing center in one year. This could occur when there is a large advertising expense (like a Super Bowl commercial) that eclipses all other expenses for the costing center that year.

Acknowledging interested parties' concerns, staff added two additional alternative tests to meet the primarily engaged requirement: a test based on employee salaries/wages, and a test based on value of production, as discussed above. Staff believes these two additional tests would account for interested parties concerns when they do not meet either the gross revenue test or the operating expense test. Staff does not believe the other four additional tests recommended by CalTax are necessary given the other options available. Staff is also concerned that the additional alternatives are not viable indicators of the primary activity of the establishment.

Additional revisions agreed on by staff and interested parties. In response to comments in other submissions, staff made additional revisions to the definition of qualified person to which staff and interested parties agree. These revisions include, for purposes of determining if an entity or establishment is primarily engaged in research and development activities, clarification that gross revenues may be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities. Staff's

[4] In their original submission, CalTax included another alternative: (7) Other reasonable measurement that is representative of an establishment's level of activity in a qualifying line of business. CalTax later withdrew this alternative.

recommendation further explains that gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a business derives 40 percent of its gross revenue from qualified manufacturing activities, 40 percent from non-qualifying activities, and 20 percent from qualifying research and development activities, the business would have met the primarily engaged test because 60 percent of the gross receipts are from qualifying activities. (See Exhibit 5, Qualcomm submission.) Staff's recommendation also clarifies that in the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business. (See Exhibit 6, DSF submission.)

In subsequent discussions, Qualcomm, DSF, and UCLA indicated that their concerns had been addressed and they did not need their additional suggested revisions put forward as alternative language for the Board to consider.

Definition of Qualified Person - Establishment

When a qualified person does not meet the primarily engaged test as a legal entity, they may still qualify as an establishment. Key to this determination is the definition of "establishment." Staff's recommendation provides that "establishment" includes multiple or single physical locations, (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

Initially, staff's proposed definition referenced only physical locations (including any portion or portions thereof). Staff believed this was an easily understood definition that would include the same group of taxpayers as discussed in the interested parties' submissions. However, staff expanded its recommendation to include "cost center" or "economic unit" to address CalTax's concerns that under staff's proposed language, some of their members would be ineligible for the exemption not because of their activities, but because their records do not reference physical location. They also pointed out that BOE audit staff would not be able to verify the establishment was primarily engaged in a qualifying activity because their records for cost centers do not reference physical addresses. CalTax was further concerned that staff's language would require businesses to recreate their financial records to show that they have a qualified establishment.

Exclusion from the Definition of Qualified Person

Subdivision (b)(6) of RTC section 6377.1 explains who is included and who is excluded from the definition of a qualified person:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
>
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:

> (i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.
>
> (ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

As explained in the prior discussion sections, staff included the provisions of RTC section 6377.1 (b)(6)(A) in proposed Regulation 1525.4 (b)(8)(A) and provided further clarification that "primarily engaged in those lines of business" could be tested at either the entity or establishment level.

The provisions of RTC section 6377.1 (b)(6)(B), however, exclude certain businesses from the definition of "qualified person." Consequently, those businesses excluded by statute cannot take advantage of the partial exemption. Staff included the provisions of 6377.1 (b)(6)(B) in Regulation 1525.4 (b)(8)(B). Staff also added clarifying information from RTC section 25128 (b) in the last sentence:

> In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

In their submission, the California Poultry Federation expressed their concern that a single entity which has both agricultural operations (e.g., NAICS code 1123) and manufacturing operations (e.g., NAICS codes 3111 or 3116) may be prohibited from claiming the partial exemption. (See Exhibit 9.) They propose that the regulation clarify that the "establishment" concept can apply such that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if it is otherwise an apportioning trade or business required to apportion its business income pursuant to subdivision (b) of the RTC section 25128.

Staff believes provisions in RTC section 6377.1 (b)(6)(B) are specific and would not allow staff to apply the establishment concept to businesses that fall under that exclusion. While RTC section 6377.1 (b)(6)(A) (Subparagraph A) describes persons who are included in the term qualified person, the statute goes on to state that notwithstanding Subparagraph A, the definition of qualified person is limited by RTC section 6377.1 (b)(6)(B) (Subparagraph B). Subparagraph B specifically excludes certain trades or businesses required to apportion their income or subject to apportionment under RTC section 25128, from claiming the partial exemption. Therefore, regardless of whether a business otherwise meets the definition of a qualified person, any business that falls under the exclusion is statutorily excluded from claiming the partial exemption.

Definition of Special Purpose Building and Foundation

Included in the definition of "qualified tangible personal property" are special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process or that constitute a research or storage facility used during those processes. The language in proposed Regulation 1525.4 (b)(9)(A)4. defining these structures was primarily taken from Regulation 1525.2, *Manufacturing Equipment*, and the MIC regulations. In their submission, CalTax suggested several deletions to these sections because they thought the sections were

unnecessarily confusing or duplicative. Staff agreed that the deleted text below was duplicative and removed it from its proposal:

> (b)(9)(A)4.a.
> "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose~~, which machinery and equipment, after installation, will become affixed to or a fixture of the real property,~~ and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

Staff believed the other recommended deletions were important to the definition of special purpose buildings and did not therefore, make those deletions. After further discussions with CalTax, they decided not to pursue their additional deletions as alternative language for the Board to consider.

Blanket Partial Exemption Certificates
Based on discussion at the interested parties meeting, staff deleted the provision in the previous draft of proposed Regulation 1525.4 (c)(2) which stated:

> Qualified persons or contractors claiming the partial exemption through a blanket exemption certificate may identify transactions subject to the partial exemption by making a clear reference to the blanket partial exemption certificate in a contemporaneous document or documents such as their written purchase orders, sales agreements, leases, or contracts. Such documents referencing the blanket partial exemption certificate must include a description of the property being purchased.

While this provision is similar to language in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*, the provision is not found in other partial exemption regulations such as Regulation 1533.1, *Farm Equipment and Machinery*. In those other partial exemption regulations, the person issuing the exemption certificate is only required to identify transactions that are not subject to the blanket certificate. Deleting the above paragraph makes proposed Regulation 1525.4 similar to the provisions found in Regulation 1533.1. Corresponding revisions were also made in Appendices A and B.

Clarification to Construction Contractors Subdivision
Based on CalTax's recommendation, staff clarified in subdivision (g)(1) who is responsible for unreported tax if it is later determined that a structure does not qualify as a special purpose building, or if material purchased under a partial exemption certificate is not used for a qualifying purpose. Specifically, if a contractor accepts an exemption certificate from a qualified person for the construction of a special purpose building and it is later determined that the building does not qualify, the qualifying person will be liable for the tax. If a contractor issues an exemption certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax.

Staff also clarified in subdivision (g) that a contractor can also be a "qualified person" because they manufacture tangible personal property. When a contractor is a qualified person, the contractor is also subject to the $200 million yearly limitation provisions separate from the limitation provisions that apply to the contractor's customers.

Claims for Refund/Offsetting Use Tax on Returns

At the suggestion of interested parties, staff previously added subdivision (h) to explain when qualified purchasers may file a claim for refund or request their vendor file a claim for tax paid on transactions subject to the partial exemption. Qualified purchasers may file a claim for refund with the Board on use tax transactions, including purchases where the use tax was collected by a retailer who reported the use tax to the Board. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale.

Staff's current recommendation also includes a suggestion by CalTax to clarify that when a purchaser is filing a claim for refund with BOE for use tax, it is not necessary for the purchaser to provide the seller with a partial exemption certificate. However, when the purchase is a sales tax transaction and the purchaser is requesting the seller file a claim for refund on their behalf, the purchaser must provide the seller with a partial exemption certificate.

In their submission, CalTax further requested a new subdivision be added to allow qualified purchasers who paid use tax (to a vendor or directly to BOE) to use any qualifying manufacturing or research and development partial exemption to offset sales and use tax liability on their sales and use tax return. To be timely, the offsetting claim must be filed with the Board or taken within the period specified in RTC section 6902. CalTax explained that filing a claim for refund may represent a substantial administrative burden for some businesses. Allowing taxpayers to claim an offset on their return would also mitigate BOE workload to process these claims for refund. In subsequent discussions with CalTax, they decided not to pursue this proposal as alternative language for the Board to consider.

Staff appreciates the withdrawal of the proposed offset procedure because staff believes the correct procedure is for the taxpayer to file a claim for refund for the overpayment. BOE does not allow purchasers to offset returns for other unclaimed tax exemptions or exclusions, even when those transactions are use tax transactions. With regard to BOE workload concerns, staff plans to monitor incoming claims for refund related to the manufacturer's exemption and will redirect staff resources or request additional resources if needed.

VI. Alternative 1 - Staff Recommendation

A. Description of Alternative 1

Staff recommends approval of proposed Regulation 1525.4 to clarify RTC section 6377.1 as provided in Exhibit 2. Staff's proposal defines terms, explains when the exemption does and does not apply, and provides sample partial exemption certificates to be used for claiming the exemption.

B. Pros of Alternative 1

Staff believes its proposal provides clear guidance that broadly interprets the provisions of RTC section 6377.1.

C. Cons of Alternative 1

Interested parties disagree with some of staff's proposed language within the definition of "qualified person." They believe that staff's proposal excludes persons that should qualify for the partial exemption.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require a regulatory change.

E. Operational Impact of Alternative 1

Staff will publish proposed Regulation 1525.4 and thereby begin the formal rulemaking process. As part of the implementation of RTC section 6377.1, staff has already sent a Special Notice to affected taxpayers and developed an industry webpage on the BOE website. The BOE's industry webpage will be updated when Regulation 1525.4 is approved by the Office of Administrative Law (OAL).

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation and updating the BOE webpage is considered routine. Any corresponding cost would be absorbed within the BOE's existing budget.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff believes its proposal clearly and broadly interprets the provisions of RTC section 6377.1. Following Board approval and authorization to publish proposed Regulation 1525.4, staff will post on the BOE website sample partial exemption certificates based on Appendices A and B.

H. Critical Time Frames of Alternative 1

The provisions of RTC section 6377.1 become operative July 1, 2014. Staff believes Board approval and authorization to publish proposed Regulation 1525.4 will provide staff and interested parties with further direction pending approval by OAL. Staff anticipates OAL will complete their review and approval of the regulation by the end of September 2014.

VII. Alternative 2

A. Description of Alternative 2

Waste Management recommends that the definition of qualified person include the language "[f]or example, the recycling industry will not be precluded from the definition of 'qualified person' for not having a specific four or six digit North American Industry Classification System (NAICS) code, provided that their activities and/or products are described in a qualified four digit industry group."

B. Pros of Alternative 2

- This alternative provides that a person will not be precluded from the definition of "qualified person" for not having a specific four or six digit NAICS code, provided their activities or products are described in a qualified four digit industry group. By an example, it includes a specific reference to the recycling industry.

- Waste Management believes these revisions are consistent with the intent of the Legislature to include within the definition of "qualified person" recyclers who are performing qualified manufacturing activities.

C. Cons of Alternative 2

- Staff believes the reference to products in the proposed language, "provided their activities <u>or products</u> are described in a qualified four digit industry group" expands the provisions of the regulation beyond the statute because it is the activities of the business that determine the NAICS code, not the products.

- Staff believes the example provided in this alternative could be confusing because some recyclers may not be in a qualifying NAICS code.

D. Statutory or Regulatory Changes for Alternative 2

No statutory change is required. However, the alternative does require a regulatory change.

E. Operational Impact of Alternative 2

Same as Alternative 1.

F. Administrative Impact of Alternative 2

1. Cost Impact

Same as Alternative 1.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 2

Waste Management believes that this alternative properly includes recyclers performing manufacturing activities.

H. Critical Time Frames for Alternative 2

Same as Alternative 1.

VIII. Alternative 3

A. Description of Alternative 3

CalTax recommends that determining whether an establishment is "primarily engaged" in a qualifying activity should include more alternative tests for a taxpayer to choose from than the options available under staff's recommendation.

B. Pros of Alternative 3

- CalTax believes this alternative would allow establishments to meet the definition of primarily engaged when they would be wrongly eliminated based on the gross revenue test, operating expense test, employee salaries/wages test, and value of production test.

C. Cons of Alternative 3

- Staff believes the four additional criteria recommended by CalTax (number of employees, employee hours, number of units produced, and capital investment) are not necessary, given the four other allowed measurements (gross revenues, operating expenses, employee wages/salaries, and value of production). Staff is also concerned that the additional alternatives are not viable indicators of the primary business activity of the establishment.

D. Statutory or Regulatory Changes for Alternative 3

No statutory change is required. However, staff's recommendation does require a regulatory change.

E. Operational Impact of Alternative 3

Same as Alternative 1.

F. Administrative Impact of Alternative 3

1. Cost Impact

Same as Alternative 1.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 3

CalTax believes this proposal qualifies persons primarily engaged in qualifying activities who may not meet the primarily engaged tests included in the staff recommendation.

H. Critical Time Frames for Alternative 3

Same as Alternative 1.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: April 2, 2014

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

BOARD OF EQUALIZATION
REVENUE ESTIMATE

Proposed Regulation 1525.4, Manufacturing and Research & Development Equipment

I. Issue

Whether the Board should approve proposed Sales and Use Tax Regulation 1525.4, Manufacturing and Research & Development Equipment, to implement and explain the partial exemption from sales and use tax for sales and purchases of tangible personal property for use in specified manufacturing and/or research and development activities that was established by Revenue and Taxation Code (RTC) section 6377.1.

II. Alternative 1 - Staff Recommendation

Staff recommends approval of proposed Regulation 1525.4 to clarify RTC section 6377.1. Staff's proposal defines terms, explains when the partial exemption does and does not apply, and provides sample partial exemption certificates to claim the exemption.

III. Other Alternative(s) Considered

Comments in response to staff's third discussion paper were received from the California Taxpayers Association (CalTax); Waste Management; Qualcomm; Downey, Smith & Fier (DSF); the University of California, Los Angeles (UCLA); Oakley, Inc.; and the California Poultry Federation. Submissions that included suggested revisions to staff's proposed language that staff did not include in its recommendation are presented as Alternatives 2 and 3.

Alternative 2 – Waste Management Recommendation

Waste Management recommends that the definition of "qualified person" not preclude the recycling industry from qualifying for the partial exemption when the business does not have a specific four or six digit North American Industry Classification System (NAICS) code, provided that their activities and/or products are described in a qualified four digit industry group.

Alternative 3 – CalTax Recommendation

CalTax recommends that with respect an establishment, the test for determining whether a qualified person is "primarily engaged" should include more alternatives than the staff recommendation.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in staff recommendation that would impact revenue. Staff's proposal defines terms, explains when the exemption does and does not apply, and provides sample partial exemption certificates to be used for claiming the exemption. Staff recommendation implements legislation declaratory of existing law. Therefore, this proposed Regulation 1524.5 does not have a revenue impact.

Other Alternatives Considered

Alternative 2 – There is nothing in alternative 2 that would impact revenue because an establishment must meet the definition for a qualified person defined as follows: RTC section 6377.1 (b)(6)(A) provides that "qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the NAICS. The definition of a qualified person is further interpreted and clarified in proposed Regulation 1525.4 (b)(8)(A).

Alternative 3 – There is nothing in alternative 3 that would impact revenue because an establishment must meet the definition for a qualified person defined as follows: RTC section 6377.1 (b)(6)(A) provides that "qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the NAICS. The definition of a qualified person is further interpreted and clarified in proposed Regulation 1525.4 (b)(8)(A).

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

Alternative 2 and Alternative 3 do not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. This estimate has been reviewed by Mr. Joe Fitz, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Chief, Tax Policy Division, Sales and Use Tax Department. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of April 2, 2014.

Regulation 1525.4, *Manufacturing and Research & Development Equipment*
Reference: Section 6377.1, Revenue and Taxation Code

(a) PARTIAL EXEMPTION FOR PROPERTY PURCHASED FOR USE IN MANUFACTURING AND RESEARCH AND DEVELOPMENT. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875 percent). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375 percent). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections, 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a) (1) or (2).

(4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) DEFINITIONS. For the purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation.

(4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) "Primarily" means 50 percent or more of the time.

(6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form, including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property.

(8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American

Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are described in a qualified four digit industry group. For the purpose of this subdivision:

1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005.

A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in, a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities.

A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in, a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of either of the following to/from a qualifying line of business: (1) employee salaries and wages, or (2) value of production.

For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a company derives 40 percent of its gross receipts from qualified manufacturing activities and 40 percent from non-qualified manufacturing activities; but the remaining 20 percent of its gross receipts are derived from qualified research and development contracts, the company would qualify because overall, 60 percent of the gross receipts are from qualifying activities.

Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination.

There may be more than one qualifying establishment within a legal entity.

In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

2. For purposes of this subdivision, "establishment" includes multiple or single physical locations (including any portion or portions thereof), and those locations or

combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712.

(B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include:

1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101.

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

(9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following:

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine

and regardless of whether the machine or component parts are assembled by the qualified person or another party.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(B) "Qualified tangible personal property" does not include any of the following:

1. Consumables with a useful life of less than one year.

2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction.

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation.

(c) PARTIAL EXEMPTION CERTIFICATE.

(1) IN GENERAL. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person.

(2) BLANKET PARTIAL EXEMPTION CERTIFICATE. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In the absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the

partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) FORM OF PARTIAL EXEMPTION CERTIFICATE. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (b)(9)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) RETENTION AND AVAILABILITY OF PARTIAL EXEMPTION CERTIFICATES. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

(5) GOOD FAITH. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3).

(d) WHEN THE PARTIAL EXEMPTION DOES NOT APPLY. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business.

(2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption.

(e) PURCHASER'S LIABILITY FOR THE PAYMENT OF SALES TAX. If a purchaser certifies in writing to the seller that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

(f) LEASES. Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

(g) CONSTRUCTION CONTRACTORS. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

(1) PARTIAL EXEMPTION CERTIFICATES. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e).

(2) CONSTRUCTION CONTRACTORS AS QUALIFIED PERSONS. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the

$200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use.

(3) $200,000,000 LIMIT. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) CLAIM FOR REFUND. Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible personal property purchased or leased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- the property is converted for use in a manner not qualifying for the exemption; **or**
- the property is used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

Description of qualified tangible personal property purchased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

From:	Buehler, Susanne
To:	Whitaker, Lynn; Oakes, Clifford; Stark, Kirsten
Subject:	FW: CalTax Comments to Proposed Reg 1525.4 -- Third Discussion Paper
Date:	Friday, February 28, 2014 3:01:18 PM
Attachments:	Comments to BOE Manuf SUT Exemption - Third Discussion 2-28.docx

---

From: Therese Twomey [mailto:Therese@caltax.org]
Sent: Friday, February 28, 2014 2:01 PM
To: Buehler, Susanne
Subject: CalTax Comments to Proposed Reg 1525.4 -- Third Discussion Paper

Susanne,

Attached please find CalTax's comments to BOE's third discussion paper pertaining to proposed regulation 1525.4, dealing with the sales/use tax exemption for manufacturing and research-and-development equipment. Please let me know if you have any questions, or would like to discuss our submittal. Thank you.

Therese Twomey

Fiscal Policy Director
California Taxpayers Association
1215 K Street, Suite 1250
Sacramento, CA 95814
916.930.3105
therese@caltax.org
www.caltax.org

following language be added after the definition of "qualified person" referenced in subdivision (b)(8)(A) of the regulations:

> "For purposes of this subdivision, a person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity.
>
> A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in a line of business described in Codes 3111 to 3399, inclusive, or 541711 or 541712 of the NAICS Codes. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity.
>
> A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of any one of the following to a qualifying line of business, as measured by:
> (1) Number of employees;
> (2) Employee hours;
> (3) Employee salaries and wages;
> (4) Number of units produced;
> (5) Value of production;
> (6) Capital investment; or
> (7) Other reasonable measurement that is representative of an establishment's level of activity in a qualifying line of business.
>
> For example, an establishment is a qualified person primarily engaged in a qualifying line of business if the number of employees allocated to research and development constitute 50 percent or more of the employees at that establishment.
>
> There may be more than one qualifying establishment within a legal entity."

Since these provisions address the "primarily engaged" definitions, we suggest deletion of the following language contained in the draft regulation as it is no longer needed.

1. ~~"Primarily engaged" means 50 percent or more of gross revenues, including intercompany and intra-company charges, are derived from the qualifying manufacturing or research and development activities described in~~

~~subdivisions (a)(1) – and (a)(3) for the financial year of the purchaser preceding the purchase of the property.~~ In the case of a nonprofit organization, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to such qualifying manufacturing activities.

~~For purposes of determining if a purchaser is "primarily engaged" in research and development activities described in NAICS 541711 or 541712, "primarily engaged" means 50 percent or more of the expenses of the establishment are for such qualifying research and development activities as described in subdivisions (a)(2) and (a)(3) for the financial year of the purchaser preceding the purchase of the property.~~

2. The proposed regulations define "establishment" to mean a single physical location where an economic activity is conducted, and further limits "establishment" to a building or interconnected structure. This definition would be limiting for manufacturers and companies engaged in R&D who conduct qualifying activities in different buildings located in a campus setting, or who conduct qualifying activities in multiple locations. To remedy this, we recommend that subdivision (b)(8)(A)(2) be deleted in its entirety, and redrafted as follows.

   > "For purposes of this subdivision, "establishment" means either an economic unit or a cost center for which separate reports are prepared for either costs, number of employees, wages or salaries, property and equipment, job costing, profit or loss, or any other type of financial data pertaining to manufacturing or research-and-development activities.
   >
   > Qualifying activities conducted at different physical locations or in different buildings that are part of the same economic unit or cost center may be considered part of the same "establishment". For example, research and development activities in two different locations but that are part of the same economic unit or cost center would be considered an "establishment"."

We also suggest definitions to clarify "legal entity".

> "For purposes of this subdivision, "legal entity" includes, but is not limited to, a c-corporation, s-corporation, limited liability company, partnership, joint venture, co-op, or sole proprietorship."

3. The proposed regulations authorize establishments primarily engaged in manufacturing to be eligible for the sales/use tax exemption on purchases of research-and-development equipment, and vice-versa. We recommend clarifying language to apply the same authorization to entities, as follows:

   > "An entity primarily engaged in manufacturing activities may purchase qualified tangible personal property that is subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity primarily engaged in

research and development may purchase tangible personal property that is subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met."

We also suggest clarification to the existing first paragraph of (b)(8)(3) pertaining to establishments as follows. Please note suggested additions are shown in bold italics, and suggested deletions are shown as strike-out.

"An establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property ***that is subject to the partial sales and use tax exemption*** for use in research and development ~~subject to the partial exemption, and vice versa~~, provided all other requirements for ***the*** exemption are met. ***An establishment primarily engaged in research and development may purchase qualified tangible personal property that is subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met."***

4. The proposed regulation outlines procedures for filing a claim for refund. While a claim for refund may be workable for some businesses, it may represent substantial administrative burdens on other businesses – not to mention the potentially significant workload that would be imposed on the BOE to process these claims. To mitigate staffing costs to the BOE and to facilitate administration, we recommend that businesses be allowed to offset refunds on their sales and use tax returns by adding the following language as a new subdivision (i) :

   "OFFSETTING CLAIM ON SALES AND USE TAX RETURN. Qualified purchasers who paid tax or tax reimbursement to the seller or the Board may use any qualifying manufacturing or research-and-development partial exemption to offset sales and use tax liability on their sales and use tax return if and only if the purchase was a use tax transaction. In order to be timely, the offsetting claim must be filed with the Board or taken within the period specified in section 6902 of the RTC.

   The taxpayer filing the return is responsible for verifying they are a qualified purchaser and maintaining adequate books and records to substantiate all manufacturing and/or research-and-development partial exemption offsets claimed."

5. Subdivision (h) of the proposed regulations appear to imply that a taxpayer claiming a refund must also issue a partial exemption certificate to the reseller.

While this should clearly be an option for the purchaser, it should not be mandated. Such a requirement would be problematic for taxpayers who may choose to forgo the exemption certificate process, and pay the full sales and use tax to the seller in order to better monitor compliance with the $200 million cap. Therefore, we suggest deletion as follows:

> **(h) CLAIM FOR REFUND.** Qualified purchasers who paid tax or tax reimbursement to the seller or the Board ~~and who thereafter issue a partial exemption certificate to the seller,~~ may file a claim for refund with the Board if the purchase was a use tax transaction; however, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

6. The proposed regulation stipulates that a contractor is also a qualified person if the contractor manufactures tangible personal property for retail sale. Some contractors process or refine tangible personal property, rather than manufacture property. Since processing, refining, fabricating and recycling are all qualifying uses of the equipment, we suggest deleting the reference to manufacturing and making a general reference.

   Also, in our last submittal we suggested the addition of language to clarify that contractors who are also qualified persons would be availed of a $200 million cap that is separate from that availed to a consumer. The regulations clarify the application of the cap with regard to materials and fixtures sold or used in a construction of a special purpose building or foundation as it relates to the consumer, but do not address the application of the cap to contractors who are also qualified persons. We reiterate the need for clarifying language as it pertains to contractors who are also qualified persons.

   To address both of these concerns, we recommend the third paragraph in (g) related to construction contractors be redrafted such that the sentence beginning with "However" reads as follows. Additions are shown in bold italics, and deletions are shown as strike-out.

   > "However, a contractor that is also a qualified person as defined in subdivision (b)(8), ***may purchase property subject to the*** *partial* ***sales and use tax*** exemption ~~because, for example, if the contractor manufactures tangible personal property for retail sale may purchase property subject to the partial exemption if all other requirements for the exemption are met.~~ ***If the contractor meets all the other requirements of a qualified person, including either the manufacturing, processing, refining, fabricating or recycling provisions under subdivision (a)(1), then the $200,000,000 million limit is applied to the qualified person's***

equipment purchases. This limit is separate and apart from the limit that is applied to materials and fixtures that are part of a contracted construction project for qualified taxpayers.

7. The proposed regulations seek to define "special purpose building and foundation". Some of the definitions are unnecessarily confusing or duplicative of statutes, and we recommend they be deleted as follows. Deletions are shown as strike-out.

   "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose~~, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) of this regulation (the qualified purpose)~~. Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

   We also recommend the deletion of (b)(9)(A)(b) and (b)(9)(A)(c) as they are unnecessary and inferred in (b)(9)(A)(e).

8. The proposed regulations require that the blanket partial exemption certificate include a contemporaneous document that provides a description of the property being purchased. This requirement runs counter to the purpose of a blanket exemption, which is to provide a general-purpose exemption for multiple equipment without individually itemizing the various equipment. We recommend deletion of the last sentence of the second paragraph under (2) BLANKET PARTIAL EXEMPTION CERTIFICATE, which reads "Such documents referencing the blanket partial exemption certificate must include a description of the property being purchased."

9. Appendix A and Appendix B, pertaining to the exemption certificate, appear to require that a blanket certificate be referenced on all purchase orders or other designated documents. Such a requirement is unnecessary and confusing, especially if the taxpayer chooses not to issue a blanket certificate. We recommend deletion of language from Appendix A and Appendix B as follows:

   If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file. ~~You must~~

~~reference this blanket certificate on future purchase orders or on other designation as provided in Regulation 1525.4 (c)(2).~~

10. The proposed regulation requires qualified persons to issue an exemption certificate to a contractor, and requires contractors to issue a different exemption certificate to retailers. The regulations do not specify the liable party in an instance where an exempt purchase is later determined to be disqualified. We suggest that the regulations provide guidance on this issue.

11. Subdivision (a)(4) of the proposed regulation provides that tangible property purchased for use by a contactor would qualify for the exemption if it is used to improve "real" property. Some construction projects involve improvements to major fixtures, which are considered personal property and not "real" property. As currently drafted, contractor purchases made to improve fixtures or major tooling equipment would be disqualified. To remedy this, we recommend deletion of "real".

12. The proposed regulations authorize exemption for qualifying pollution control equipment and define "pollution control" to mean pollution abatement activities that meet or exceed the government standards that are in place at the time the qualified equipment is purchased. This provision provides a safe harbor for equipment purchases to the extent pollution reduction requirements change between the time the equipment is purchased and when it is placed into operation. We suggest that this safe harbor be extended to leased equipment, and the language specify that such equipment qualifies if it meets the pollution control standards that are in place at the time the lease is initiated.

13. In (c)(1), the proposed regulations erroneously cross-reference (c)(4) as the section pertaining to good faith acceptance of an exemption certificate. The reference (c)(4) should be change to (c)(5) in the first and fifth paragraphs of subdivision (c)(1).

14. In (c)(3)(E) pertaining to the exemption certificate, we recommend language clarifying that a purchaser may be <u>either</u> a qualified person primarily engaged in qualifying activities <u>or</u> a contractor for a qualified person, but is not required to be both.

WASTE MANAGEMENT

Public Affairs
915 L Street, Suite 1430
Sacramento, CA 95814
916/552-5859
916/448-2470Fax

March 4, 2014

Ms. Susanne Buehler, Chief
Tax Policy Division (MIC:92)
Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0092

Via Email: Susanne.Buehler@boe.ca.gov

Subject: Comments to State Board of Equalization's Proposed Regulation 1525.4 (Manufacturing and Research & Development Equipment)

Dear Ms. Buehler:

Waste Management (WM) appreciates the Board of Equalization (BOE) staff efforts in soliciting input and providing guidance to taxpayers on this very important issue. As highlighted at the third interested parties meeting, the issues around determining if a taxpayer qualifies for the exemption have not been fully resolved. Our comments revolve around two main concerns:

1) whether the determination may be made at the entity-level, the establishment-level, or both, as expressed at the meeting; and

2) the application of the North American Industry Classification System (NAICS) codes to recycling.

To this point, we respectfully suggest that clarification with respect to recycling may be warranted since recycling is clearly contemplated within the statute, yet does not fall neatly into a single NAICS code. *See* Cal. Rev. and Tax. Code § 6377.1(a)(1).

Also, your sister state Department, CalRecycle, is heavily engaged in developing incentives to support investment in recycling infrastructure. I have cc'd CalRecycle's Director, Caroll Mortensen and her key Deputy Directors on this letter.

We appreciate the opportunity to provide our perspective on these issues, as further discussed below.

Specific Comments:

1) **<u>The term "establishment" should include a bright-line test for qualifying manufacturing activities that maintain separate books & records.</u>**

In reviewing this third draft of the proposed regulation, we agree with the general consensus that "primarily engaged" may be determined at either the entity-level or at the establishment-level, based on the existence of separate books and records for the economic unit or activity.

The proposed regulation defines "establishment" to mean a single physical location where an economic activity is conducted and further limits "establishment" to a building or interconnected structure. We believe this is too restrictive and does not allow for a single location performing multiple economic activities or for multiple locations performing the same qualifying activities.

This may be remedied by deleting subdivision (b)(8)(A)(2) as currently proposed by BOE, and redrafting it to read as follows:

> "For purposes of this subdivision, "establishment" may include either a single or multiple physical locations where a qualified economic activity is performed, and which has separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified economic activity.
>
> A physical location may be described in more than NAICS code.

2) **<u>The 4 digit NAICS code for "Recycling" should be the code of the raw material being processed.</u>**

Pursuant to Section 6377.1(b)(6)(A), a qualified person must be primarily engaged in a line of business described in codes 3111 to 3399, inclusive, or 541711 or 541712.

The statute clearly invokes the 4 digit NAICS codes for manufacturing; yet for R&D the full 6 digit codes are specified. Thus, the legislature distinguished between 4 and 6 digit codes.

"NAICS is a 2- through 6-digit hierarchical classification system, offering five levels of detail. Each digit in the code is part of a series of progressively narrower categories, and the more digits in the code signify greater classification detail. The first two digits designate the economic sector, the third digit designates the subsector, the fourth digit designates the industry group.[1]"

[1] http://www.census.gov/eos/www/naics/faqs/faqs.html#q5

The fifth and sixth digits are country-specific and not relevant for purposes of 6377.1(b)(6)(A), even though a complete and valid NAICS code contains six digits.

Recycling does not have a unique 4 digit NAICS industry group. Rather, recycling generally falls under the 4 digit code of the raw material being recycled. Waste Management operates facilities that processes various waste streams into raw materials which are then sold to other manufacturers. For example:

- Glass is received by Waste Management and then is sorted, crushed, sized cleaned, and processed into an intermediate product that is then sold to other manufacturers for further processing. This activity would fall under the industry group 3272, Glass and Glass Product Manufacturing.

- Plastic, Metals and Paper are first sorted, then may be sized, crushed or shredded and then baled or otherwise packaged or containerized for shipment. The baled, packaged or containerized product is sold to a customer for further processing. These activities should fall in the NAICS code of the material being processed and sold. 3261 for plastics, 331X based on the type of metal and 3222 for paper products.

We believe that language should be incorporated into the proposed regulation to clarify the proper use of the NAICS codes for a qualified taxpayer performing recycling activities. Such language should permit recyclers to invoke the applicable 4 digit industry group of the material being processed for sale.

This may be accomplished either by a special provision for the recycling industry, or be revising subdivision (b)(8)(A) to read as follows:

> " 'Qualified person' means a person that is primarily engaged in those lines of business described in the manufacturing sector Codes 3111 to 3399, inclusive, research and development sector codes 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. For purposes of this subdivision, with respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "Qualified person" for not having a specific six digit NAICS code, provided that their activities or products are described in a qualified 4 digit industry group. For example, the recycling industry will not be precluded from the definition of a "Qualified person" for not having a specific four or six digit NAICS code, provided that their activities and/or products are described in a qualified 4 digit industry group."

This provision would clearly allow investments in recycling infrastructure to be eligible for the partial sales and use tax credit envisioned by BOE proposed Rule 1525.4, regardless of where that recycling infrastructure is located. This will allow WM and others in the solid waste and

recycling industry to take advantage of the partial sales and use tax exemption for equipment and property used in California for purposes of "Recycling" in accordance with the definition currently proposed in Rule 1525.4.

Thank you for the opportunity to provide these comments for your consideration. WM is hopeful that you will agree that the interpretations we are suggesting will promote recycling in California and are consistent with both the letter and intent of SB 90 and other policies and programs of the State of California.

Very truly yours,

Charles A. White, P.E.
Director of Regulatory Affairs/West

cc: Caroll Mortensen, Director, CalReycle, caroll.mortensen@calrecycle.ca.gov
Scott Smithline, Deputy Director, CalRecycle, scott.smithline@calrecycle.ca.gov
Howard Levenson, Deputy Director, CalRecycle, howard.levenson@calrecycle.ca.gov
Lynn Whitaker, BOE, lynn.whitaker@boe.ca.gov

QUALCOMM

QUALCOMM Incorporated

5775 Morehouse Drive
San Diego, CA 92121-1714

www.qualcomm.com

February 28, 2014

Suzanne Buehler, Chief
Board of Equalization
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092

by Email: Susanne.Buehler@boe.ca.gov

Re: Comment for Proposed Regulation §1525.4 – Third Discussion Paper

Dear Ms. Buehler,

I would like to thank you and your team for taking the time and effort to collaborate with taxpayers on regulatory drafts. Thoughtfully constructed regulations save countless hours during the compliance and audit processes. During the Third Interested Parties meeting on February 18, 2014 staff requested written recommendations outlining industry input. I am writing with my comments and suggestions for Proposed Regulation §1525.4.

Qualified Person – "Primarily Engaged"

To keep the exemption as inclusive as allowable, we recommend that the test to determine whether a taxpayer is "Primarily Engaged" is 50% or more of all activities in the qualifying NAICS codes and have tests based on Gross Revenues or Expenses.

Test Based on Gross Receipts

As drafted:

1. "Primarily engaged" means 50 percent or more of gross revenues, including intercompany and intra-company charges, are derived from ~~the~~ qualifying manufacturing ~~or research and development~~ activities described in subdivisions (a)(1) —and (a)(3) for the financial year of the purchaser preceding the purchase of the property. In the case of a nonprofit organization, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to such qualifying manufacturing activities.

Recommended changes:

1. "Primarily engaged" means 50 percent or more of gross revenues, including intercompany and intracompany charges, are derived from qualifying manufacturing or research and development activities described in any qualifying NAICS classifications ~~subdivisions (a)(1) and (a)(3)~~ for the ~~financial~~ fiscal year of the ~~purchaser~~ seller preceding the purchase of the property. For purposes of research and development activities, revenues could be derived from selling research and development services or licensing intellectual property resulting from research and development activities. In the case of a

> nonprofit organization, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to such qualifying manufacturing or research and development activities.

The recommended change also acknowledges that companies can sell research and development services or license their intellectual property resulting from research and development.

Test Based on Expenses

As drafted:

> For purposes of determining if a purchaser is "primarily engaged" in research and development activities described in NAICS 541711 or 541712, "primarily engaged" means 50 percent or more of the expenses of the establishment are for such qualifying research and development activities as described in subdivisions (a)(2) and (a)(3) for the financial year of the purchaser preceding the purchase of the property.

Recommended changes:

> Alternatively, "primarily engaged" means 50 percent or more of operating expenses are derived from qualifying manufacturing or research and development activities described in any qualifying NAICS classifications for the fiscal year of the purchaser preceding the purchase of the property. Operating expenses consist of expenses derived from the routine operation of business and should exclude non-operational expenses such as income taxes.

We recommend using the term "operating expenses" rather than "expenses". Operating expenses should be expenses derived from the routine operation of business and should exclude items such as income taxes or payment to settle a lawsuit. Providing general guidelines will help taxpayers and auditors understand the intent of the test while contemplating the wide variety of businesses and their financial activities.

The recommendations also increase the opportunity for a taxpayer to qualify for the exemption by having the option to apply the gross revenue or expense test for both manufacturers and research and development performers.

Test Includes All Activities in Qualifying NAICS Codes

The test to determine whether "50% or more" is satisfied should include all activities described in the qualifying NAICS codes. A taxpayer should be able to combine both the manufacturing and research and development activities to determine if the test is met. Including all activities listed in the qualifying NAICS codes appears consistent with the plain reading of CRTC §6377.1(b)(6)(A) as follows:

> "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.

We recommend including an example such as.

> For purposes of this subsection, the test for Gross Revenues means that the gross revenues are derived from sales of products the qualifying person manufactures, or sells from performing research and development contracts in combination, rather than derived from other commercial activity. For instance, if a company derives 40% of its receipts from tangible personal property it manufactures (qualifying), 40% from tangible personal property manufactured by others (non-qualifying) and 20% from performance of research and

development contracts (qualifying), it would qualify because overall, 60% of the receipts are from qualifying activities.

Similarly, the test for Operating Expenses means expenses from manufacturing or research and development activities cited in the qualifying NAICS codes in combination.

Taxpayers should be able to perform all of the types of manufacturing and research and development activities listed without risk of being precluded from the exemption because a single NAICS activity is not the majority activity. CRTC §6377.1(b)(6)(A) seems to also contemplate that a qualifying taxpayer could engage in more than one NAICS-defined activity by use of the term "those lines of business" rather than stating "a line of business". Further, CRTC §6377.1(b)(6)(A) does not appear to refer to the NAICS codes in a way that states the manufacturing group of 3111 to 3399 should be a separate class than the research and development codes of 541711 and 541712.

Recommendation to Eliminate Reference to Assets Only for R&D Qualifications

In subsection (b)(8)(A)(1) paragraph 2, we also recommend deleting the reference to "subdivisions (a)(2) and (a)(3)" which specifically refers to tangible personal property ("TPP"). TPP can be a small component compared to the labor expenses of a research and development function. Comparing only the TPP used for research and development to all other expenses would preclude most taxpayers from being a "Qualified Person".

Qualified Person – "Line of Business"

The most recent draft of Regulation §1525.4 defines a "Qualified Person" using an analysis of the income statement elements of Gross Receipts and Expenses. The measurement is at the level of "establishment", which is deemed "a single physical location where economic activity is conducted". This seems like a very specific test requiring data that many companies may not have readily available.

I recommend that staff use a company's existing financial data to develop tests that will satisfy the "Qualified Person" test. It is common for companies to have income statement data at the legal entity level, and at subsets within a legal entity such as department or cost center. The companies' internally designated subsets of financial measurements may reasonably represent a line of business more closely than a "single physical location".

For ease of administration and inclusion we recommend a multi-tier test for "Qualified Person". First, use the 50% or more test at the entity level for the entire entity to qualify. Second, use an economic unit that is a subset identified within the taxpayers records (i.e., cost center or department) that is reasonable and consistent with a line of business.

As drafted:

2. For purposes of classifying a line or lines of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the economic activity in which the establishment is primarily engaged. ~~establishment's single most predominant activity based upon gross revenue, including intra-company charges. An establishment is not necessarily identical with the enterprise or company which may consist of one or more establishments. Also, an establishment is to be distinguished from subunits of the establishment such as departments.~~ The term "establishment" means a single physical location where economic activity is conducted, such as manufacturing, construction, wholesale, research and development, or other such economic activities for which the NAICS provides a code. A single physical location includes a building, interconnected structure, or other such improvement to realty. For example, a factory, mill, store, winery, warehouse, research and development building, or manufacturing plant

is generally a single physical location. If a single entity or enterprise conducts different economic activities at multiple different establishments in the same geographic area, such as a group of separate and distinct buildings arranged in a campus setting, each building or structure shall be considered a separate establishment.

Where a single establishment derives gross revenue from manufacturing activities and also engages in research and development activities at a single physical location, the two activities shall each be examined separately. That is, if 50 percent or more of gross revenue at that single establishment are from qualifying manufacturing activities or 50 percent or more of total expenses of the establishment are for qualifying research and development activities, then the establishment qualifies and all purchases of qualified tangible personal property qualify for the partial exemption.

As recommended:

3. For purposes of classifying a line or lines of business, the economic unit will be the "establishment". The term "economic unit" means a single legal entity or a subgroup within a legal entity that is tracked within the legal entity's accounting records for which separate reports can be prepared. A subgroup may include, but is not limited to, a department or a cost center. The highest level of legal entity or subgroup at which the economic unit is a qualifying person is the level to which the term "qualifying person" applies. There may be more than one "establishment" in a single legal entity.

   [Remove the second paragraph and substitute the recommendation under heading *Test Includes All Activities in Qualifying NAICS Codes.*]

Thank you for your time and consideration regarding these comments and recommendations. If I can assist in any way, please feel free to call me and discuss any questions or comments at 858-651-8354.

Very Truly Yours,

Sandra Schaper
Qualcomm Incorporated

DOWNEY·SMITH·FIER
STATE & LOCAL TAX

February 27, 2014

Susanne Buehler
Chief, Tax Policy Division
Sales and Use Tax Department
Board of Equalization
450 M. Street
Sacramento, CA 94279-0092

Re: Comments on Proposed Regulation 1525.4 (Mfg. and R & D Partial Exemption)

Thank you for the opportunity to continue to participate in the Interested Party discussion and the drafting of the new Regulation for Manufacturing and R&D Equipment. We definitely view this as a critical and productive process and although there are no additional discussions scheduled, we are encouraged by the Board of Equalization's verbal comments during the Interested Parties Meeting ("IPM") and willingness to address the concerns surrounding the definition of a "qualified person".

Downey, Smith & Fier has the following comments related to three areas of proposed Regulation 1525.4:

1. As discussed in the February 18, 2014 IPM, DSF agrees that it is necessary to modify or expand the proposed Regulation to clearly set forth that a "qualified person" includes any business enterprise with an overall or aggregate NAICS code that falls within the prescribed range of 3111 to 3399, inclusive and 541711 or 54712, without requiring separate qualification based on any concept of establishment.

   Note: This change should have little, if any, impact on the scope of the exemption as a qualified person must also support that any claimed property is "qualified property" used in a qualified activity.

2. Our second point also involves "qualified person", more specifically, the concept of "establishment" as the Board has set forth in the proposed Regulation. Again, we agree with the discussion during the IPM that the concept of "Establishment" must be easily determined by a taxpayer, consistent with the way that businesses maintain their books and records and something that can be audited. Physical location presents a significant challenge for both taxpayers to determine qualification and for State Auditors to verify as generally financial records are not maintained in this manner. Furthermore, we strongly believe that when separate and distinct economic activities are conducted within a business, the fact that those

4010 Watson Plaza Drive, Suite 190 · Lakewood, CA 90712
Office: 562.249.6000 · Toll Free: 888.451.1700 · Fax: 562.249.6059

activities are in separate or different locations should not impact the determination of a qualified person.

As discussed during the IPM, the concept of establishment may need to be different for manufacturing verses Research and Development activities.

It is our understanding that the California Taxpayers Association ("CTA") will be submitting proposed language to revise the definition of "establishment" as used in the Regulation. We also understand that CTA's proposal will be oriented towards for-profit enterprises. We recommend that any language adopted be expanded to include terminology specific to not-for-profit businesses or government organizations, such as object codes, function, grants, gifts and other types of fundings, etc.

Accordingly, we suggest the following language be included after the general definition of an establishment:

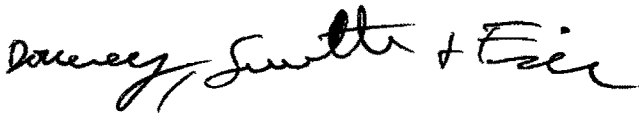
> "For not-for-profit organizations or governmental entities, an establishment would include the smallest economic unit for which funding and expenditure information is maintained on activities defined in the range of NAICS codes subject to the partial exemption and be represented by, but not limited to: functions, funds, grants, gifts or other types of separate financial records."

3. Under paragraph (b)(8)(A)1., second paragraph should include the following language:

> "In the case of a not-for-profit organization or governmental entity, "primarily engaged" means 50% or more of the funds allocated to the establishment are attributable to such qualifying Research and Development activities."

Thank you for your consideration.

Sincerely,



Downey, Smith & Fier ("DSF")

Cc: Lynn Whitaker

UNIVERSITY OF CALIFORNIA, LOS ANGELES

UCLA

BERKELEY • DAVIS • IRVINE • LOS ANGELES • MERCED • RIVERSIDE • SAN DIEGO • SAN FRANCISCO

SANTA BARBARA • SANTA CRUZ

February 27, 2014

UCLA TAX SERVICES
10920 WILSHIRE BLVD., 5TH FLOOR
LOS ANGELES, CALIFORNIA 90024-6502
PHONE: (310) 794-0538
FAX: (310) 794-8147
www.tax.ucla.edu

Susanne Buehler
Chief, Tax Policy Division
Sales and Use Tax Department
Board of Equalization
450 M. Street
Sacramento, CA 94279-0092

Re: Comments on Proposed Regulation 1525.4 (Mfg. and R & D Partial Exemption)

Dear Ms. Buehler:

On behalf of UCLA, we are very interested in the discussions that have taken place regarding the proposed language to be used in Regulation 1525.4. Downey, Smith & Fier (DSF) has been updating us on the latest developments in this process and we have participated in the Interested Parties Meetings as well. We agree with DSF's language regarding not-for-profit and governmental organizations as stated in the letter dated February 27, 2014 attached to this email. We respectfully request that the Board adopt such language in the new Regulation.

Our interest stems from the important role research plays at UCLA and how it represents a distinct function at our University. Research is one of our four core principals, along with education, patient care, and public service, and it serves as an integral part of our University's mission, operations and strategic goals. This clearly represents an economic unit in our financial records and organization, with separate accounting at a cost center/fund level for expenditures. Accordingly, the language adopted should reflect our research functions as an establishment. Based on our understanding of the current status and direction of the language to be used in the Regulation, we want to express our agreement in broadly defining an establishment and that any language should support not-for-profit and governmental entities and the way these entities maintain their financial information, including, but not limited to: function, funds, object codes, financial accounting units, etc.

Sincerely,

Scott Monatlik
Director, Tax Services
University of California, Los Angeles

February 28, 2014

Board of Equalization
Susanne Buehler
Chief, Tax Policy Division
Sales and Use Tax Department
450 M. Street
Sacramento, CA 94279-0092

VIA: Email: Susanne.Beuhler@boe.ca.gov

Re: Proposed Regulation 1525.4 (Mfg. and R & D Partial Exemption) Comments

It was a pleasure to be able to listen in on the recent conference call/meeting for the Interested Party discussion on February 18, 2014 about the drafting of the new Regulation for Manufacturing and R&D Equipment. As a Taxpayer, ("Oakley"), we absolutely view this proposed regulation as an important process and want to make sure the Board of Equalization ("BOE") and other California Taxpayers work together to and make sure the regulation ensures all eligible persons to have an equal benefit to the regulation. Although the BOE has not scheduled any additional discussions, we believe the BOE will review all parties' comments thoroughly and willingly by addressing the concerns around the definition of a "qualified person" from all parties small and large.

Oakley has the following comments related to the proposed Regulation 1525.4:

- From the discussion during the Interested Party Meeting ("IPM"), Oakley supports the BOE for wanting to expand and revise the definition of a "qualified person". We agree with the discussion and proposed regulation describing a "qualified person", a person that is primarily engaged in those lines of a business described by the North American Industry Classification System ("NAICS") within Codes with the prescribed range of 3111 to 3399, inclusive and 541711 or 54712, without requiring separate qualification based on any concept of establishment.

OAKLEY, INC.
ONE ICON
FOOTHILL RANCH
CALIFORNIA 92610

PHONE: 949.951.0991
FAX: 949.699.3500
WWW.OAKLEY.COM

Ms. Susanne Buehler
Proposed Regulation 1525.4-Manufacturing and R&D Equipment
Comments
February 28, 2014

- As Oakley is a manufacturer in California, with multiple legal entities that surrounds the overall business of manufacturing, research and development, wholesale, and retail with multiple departments we agree that it would qualify as a "qualified person" under the definition, but also understand that not 100% of the legal entity which houses the manufacturing, research and development and other corporate functions would be able to take advantage of Regulation 1525.4 for the whole legal entity. During the IPM, we agree that the concept of "Establishment" must be easily determined by a taxpayer, consistent with the way that businesses maintain their books and records and for which something can be audited. For Oakley, we have cost centers that help support areas of manufacturing and research and development ("R&D"). We would have multiple establishments that would have some form of this area along with other non-manufacturing/R&D functions. Physical location presents a major challenge for both taxpayers to determine qualification and for BOE Auditors to verify taxpayer's books and records which are not maintained in this manner. Furthermore, we strongly believe that when separate and distinct economic activities are conducted within a business, the fact that those activities are in separate or different locations should not impact the determination of a qualified person.

Thank you for your consideration.

Sincerely,

Timothy Hall
Oakley
Tax Project Manager

Cc: Lynn Whitaker (VIA: Email Lynn.Whitaker@boe.ca.gov)

OAKLEY, INC.
ONE ICON
FOOTHILL RANCH
CALIFORNIA 92610

PHONE: 949.951.0991
FAX: 949.699.3500
WWW.OAKLEY.COM

CALIFORNIA POULTRY FEDERATION

4640 SPYRES WAY, SUITE 4
MODESTO, CA 95356
PHONE: (209) 576-6355
FAX: (209) 576-6119
WWW.CPIF.ORG

February 27, 2014

Ms. Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092

Re: Comments on Proposed Regulation 1525.4

Dear Ms. Buehler:

The California Poultry Federation is pleased to submit the following comments regarding proposed Regulation 1525.4.

The current draft of the proposed regulations issued with the Third Discussion Paper on January 31, 2014 made revisions to clarify that the definition of a "qualified person" is based on establishments within an entity rather than the entity itself. Specifically, Regulation Section 1525.4(b)(8)(A)(3) states:

> *Where a person conducts business at more than one establishment, then that person shall be considered to be a "qualified person" for proposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399...*

However, Regulation Section 1525.4(b)(8)(B) states that a qualified person does not include:

> *An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128... these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity...*

Our concern is that an entity which has both agricultural operations (e.g., Code 1123) and manufacturing operations (e.g., Code 3111 or 3116) in the same entity may be prohibited from claiming the exemption. We propose that the regulations clarify that the "establishment" concept can apply such that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if it is otherwise an apportioning trade or business required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

The California Poultry Federation thanks you for your consideration of our views on this issue of importance to our members.

Sincerely,

Bill Mattos

Bill Mattos
President

EXECUTIVE COMMITTEE MEMBERS AND OFFICERS

MIKE LEVENTINI, PETALUMA POULTRY PROCESSORS - CHAIRMAN • DAVID PITMAN, PITMAN FAMILY FARMS - VICE CHAIRMAN
LILLIAN ZACKY, ZACKY & SONS POULTRY - SECRETARY/TREASURER
RICHIE KING, FOSTER FARMS - PAST CHAIRMAN
BILL MATTOS, CALIFORNIA POULTRY FEDERATION - PRESIDENT

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

APRIL 22, 2014

BUSINESS TAXES COMMITTEE

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

Juli Price Jackson

CSR NO. 5214

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)

41756379-562b-42c1-b7e7-981f1501bd65

1 P R E S E N T
2
3 For the Committee: Michelle Steel
Chair
4
5 Betty T. Yee
Member
6
7 Jerome E. Horton
Member
8
9 George Runner
Member
10
11 Marcy Jo Mandel
Appearing for John
12 Chiang, State Controller
(per Government Code
13 Section 7.9)
14
Joann Richmond
15 Chief
Board Proceedings
16 Division
For Board of
17 Equalization Staff: Susanne Buehler
Chief
18 Tax Policy Division
19 Lawrence Mendel
Tax Counsel III
20 Legal Department
21 Michele Pielsticker
Chief
22 Legislative and Research
Division
23
Lynn Whitaker
24 Business Taxes
Specialist II
25 Sales and Use Tax
Department
26
27 ---oOo---
28

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

INDEX OF SPEAKERS

SPEAKER	PAGE
Therese Twomey Fiscal Policy Director California Taxpayers' Association	6
Joe Vinatieri Attorney Bewley, Lassleben & Miller LLP	11
Nicole Rice Policy Director California Manufacturers & Technology Association	18
Bill Mattos President California Poultry Federation	20
Brian Grant Tax Director Foster Farms	21
Chuck White Director of Regulatory Affairs Department of Waste Management	31
Ralph Chandler Regulatory Affairs Director California Refuse and Recycling Coalition	35
Ken Dunham Executive Director West Coast Lumber & Building Material Association	90

---oOo---

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 APRIL 22, 2014
4 ---oOo---
5 MR. HORTON: Ms. Richmond, what is our next
6 matter?
7 MS. RICHMOND: Our next matter is the
8 Business Taxes Committee. Ms. Steel is Chair of
9 that committee.
10 Ms. Steel.
11 MS. STEEL: I call the Business Taxes
12 Committee meeting to order.
13 I have -- while Ms. Susanne Buehler coming
14 out, I have seven speakers here. And Mr. Bill
15 Mattos, California Poultry. And Joe Vinatieri.
16 Chuck -- Mr. Chuck White. Ms. Therese Twomey. And
17 Mr. Ralph Chandler. And Mr. Brian Grant. And Ms.
18 Nicole Rice.
19 And we have three seats, so I follow
20 Chairman's first step. Like three people came here
21 first, and then you can sit at the first row.
22 Okay. Ms. Buehler.
23 MS. BUEHLER: Good morning. I am Susanne
24 Buehler with the Sales and Use Tax Department.
25 We have two agenda items for your
26 consideration this morning. We will take each
27 agenda item and their respective action items
28 separately before moving to the next.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 With me for Agenda Item 1 is Mr. Larry
2 Mendel from our Legal Department.
3 For this agenda item we request your
4 approval and authorization to publish proposed Sales
5 and Use Tax Regulation 1525.4, Manufacturing and
6 Research and Development Equipment.
7 Proposed Regulation 1525.4 implements and
8 explains the partial exemption from sales and use
9 tax for sales and purchases of manufacturing and
10 research and development equipment established by
11 Revenue and Taxation Code Section 6377.1.
12 We have three action items; one for the
13 concurred issues, and two on areas of disagreement.
14 We will take up each action item separately,
15 including any speaker's presentations, before moving
16 on to the next action item.
17 For Action 1, it represents those areas
18 agreed upon by staff and interested parties and
19 includes definitions of terms, explanations of when
20 the exemption does and does not apply and sample
21 exemption certificates.
22 We ask that the Board approve and authorize
23 these subdivisions for publication.
24 We may have speakers on this action item.
25 We would be happy to answer any questions you may
26 have after their presentation.
27 MS. STEEL: So out of those seven speakers,
28 who's going to speak on Action 1?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2 THERESE TWOMEY

3 ---oOo---

4 MS. TWOMEY: Therese Twomey with California

5 Taxpayers' Association.

6 If I may briefly speak on Action 1. And we

7 also have Action Alternative Number 3, I believe, is

8 our proposed alternative language.

9 MS. STEEL: So just you for Action 1?

10 MS. BUEHLER: Action 1 is the concurred

11 items at this point.

12 MS. STEEL: Con- -- yeah.

13 MS. MANDEL: So on the concurred items, do

14 you want to say thank you for working with us?

15 MS. TWOMEY: Yes.

16 Well, first of all, if I can kind of

17 address the whole thing and kind of save the --

18 the -- the Board time.

19 First of all, thank you to the Board

20 Members for your leadership on this issue. This is

21 a very important issue for manufacturers in

22 California.

23 Since the expiration of the MIC, the

24 Manufacturer's Investment Credit, California has not

25 had anything to incentivize manufacturers or

26 research and development in California. The

27 legislature took it upon themselves to provide a

28 competitive incentive for manufacturers and R&D to

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 stay in California, and this is the result.
2 We'd also like to thank your staff as well
3 as the Sales Tax Division staff and the Legal staff
4 for working with us and being very diligent on
5 moving this regulation towards where it is today.
6 It's been a long process. It's been a
7 productive process. And we agree with the
8 regulations except for one area. And that area has
9 to do with how taxpayers at the establishment level
10 may demonstrate their qualification for the partial
11 sales and use tax exemption.
12 We want to emphasize that this is not an
13 expansion of what is under the current regulations.
14 It is -- or an expansion of what is eligible under
15 the current statute. This is simply another
16 alternative for qualified taxpayers to demonstrate
17 their eligibility.
18 And that leads into the Alternative 3. And
19 what we're asking for is we're asking that the Board
20 consider the addition of the number of employees as
21 a consideration for established -- establishments
22 that demonstrate qualification. If we don't include
23 the number of employees as a test, a couple of
24 things may happen. One, taxpayers who are qualified
25 under the statute may be disqualified from the
26 regulations. Number two, if we don't adopt that,
27 then there could be an incidence or instances in
28 which taxpayers who are in a lower level R&D

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 research who don't conduct the white lab coat, you
2 know, PhD or genetic testing, would be competitively
3 disadvantaged or completely disqualified.
4 You know, when we think of R&D, we think of
5 professors in white lab coats, but not all
6 industries have those. There are certain industries
7 that qualify as manufacturers under the NAICS codes,
8 such as pet food manufacturers, who do conduct R&D
9 but they don't always require, you know, highly paid
10 or highly compensated researchers.
11 And, you know, in summary, our request for
12 the addition of number of employees, once again, is
13 simply to allow those taxpayers who qualify under
14 the statute to be able to demonstrate their
15 eligibility under the regs. It's the established
16 ways by which businesses measure their cost or the
17 ways that they measure under a call center or a
18 department.
19 You know, the staff has been very
20 accommodating in taking a look at our concerns and
21 adding the operating expenses as well as gross
22 revenue, value production, as well as employee
23 salaries and wages. But without the number of
24 employees, we would be severely disadvantaging those
25 industries that do not have highly sophisticated
26 R&D.
27 And, with that, that's why we are
28 requesting a modification of Alternative 3, to add

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 just that one segment. Initially, we had requested
2 other parameters. But the parameters are similar
3 enough where if we had the number of employees, we
4 would not need the hours of employees engaged in
5 either manufacturing or R&D.
6 MS. STEEL: Thank you, Ms. Twomey.
7 Let's do this: Staff goes through all
8 alternatives here -- 1, 2, 3 -- and then we going to
9 listen from the speakers.
10 MS. BUEHLER: Okay.
11 MS. STEEL: So let's go for Number 2 and
12 then we going to hear it.
13 MR. RUNNER: Hang -- my -- just real quick.
14 I'm trying to get on the same page here.
15 My notes show us as two issues. So -- and
16 I think what I heard you say is three issues.
17 MS. STEEL: Three alternatives.
18 MS. BUEHLER: We have three issues. The
19 first covers everything that was consented to --
20 MR. RUNNER: Okay.
21 MS. BUEHLER: -- from interested parties
22 and staff.
23 MR. RUNNER: So the first issue's going to
24 be all the consent items.
25 MS. BUEHLER: Right.
26 MR. RUNNER: Let me just clarify. The
27 second issue is going to be the concern -- or the
28 third issue, I believe, would be the concern that we

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 just heard from CalTax.
2 MS. BUEHLER: That's correct.
3 MR. RUNNER: Is the second item then this
4 concern in regards to recycling?
5 MS. BUEHLER: Yes, it is.
6 MR. RUNNER: Thank you. Okay, I'm on page
7 then.
8 MS. BUEHLER: Okay. All right. So we'll
9 continue with Action 2.
10 We ask the Board to approve and authorize
11 for publication either staff's recommendation that a
12 person will not be precluded from the definition of
13 a "qualified person" when there is no six digit
14 NAICS code to describe their line of business,
15 provided their business activities are described in
16 a qualified four digit industry group.
17 Or Waste Management's recommendation which
18 provides that a person will not be precluded from
19 the definition of a "qualified person" when there is
20 no six digit NAICS code to describe their line of
21 business, provided their activities or products are
22 described in a qualified four digit industry group.
23 This recommendation includes an example
24 specific to the recycling industry.
25 In Action Item 3, we ask that the Board
26 approve and authorize for publication either staff's
27 recommendation which tests whether a qualified
28 person is primarily engaged based on revenues or

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 operating expenses of the entity or establishment.
2 Staff's recommendation further provides
3 that an establishment may test if they are primarily
4 engaged based on either employee's salaries and
5 wages or value of production.
6 Or CalTax's recommendation which, in
7 addition to the tests suggested by staff, tests
8 whether a qualified person is primarily engaged
9 based on the number of employees, employee hours,
10 number of units produced, or capital investment.
11 MS. STEEL: Thank you.
12 So next speaker, Mr. Vinatieri.
13 ---oOo---
14 JOE VINATIERI
15 ---oOo---
16 MR. VINATIERI: Yes. Thank you, Ms. Steel.
17 Just very briefly. I'm going to give just
18 a little slightly different spin.
19 First of all, this, as the Board knows, is
20 a very, very important regulation for purposes of
21 California's competitive ability to gain, regain
22 manufacturing jobs. And I think you all know that.
23 And I just want to say that this has been a
24 very collaborative process on the part of the staff
25 and the taxpayers. I've been very impressed with
26 the fact that we actually had three interested
27 parties meetings -- that's a very, very rare
28 thing -- and the fact that everyone seemed to be on

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 the same page relative to being as beneficial with
2 this as possible, to be as liberal as possible in
3 finding people who are going to benefit from this.
4 So kudos to the staff and to the industry
5 for working together. And the fact is that there's
6 only two issues here on a hugely difficult
7 regulation. So I think it speaks a lot.
8 But I want to bring a little different
9 aspect to this and that is that, as businesses
10 look -- and I might be a little premature, but I
11 think it's important that we get this out now. As
12 businesses look to utilize this new regulation come
13 July 1st, there's going to be areas of uncertainty,
14 notwithstanding all that we've attempted to do to
15 clarify situations as much as possible.
16 And with that uncertainty and with the
17 desire to encourage businesses to make these
18 manufacturing equipment investments and R&D
19 investments, we need to have a way of taking out
20 some of that uncertainty that will undoubtedly occur
21 for some businesses based upon the uniqueness of
22 their business or their line of business.
23 So as such, I want to encourage the Board,
24 the staff and the Board, to focus and help
25 businesses that would like to have advice -- advice
26 from the staff on whether their purchase of a
27 particular piece of equipment will meet the
28 requirements of the new 1525.4.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 This probably will be in the form of a
2 reasonable reliance, 6596 request. But candidly --
3 and I think we all know this -- most taxpayers don't
4 know they can utilize that process to gain certainty
5 and to protect themselves. In light of encouraging
6 businesses to make those equipment purchases to
7 provide jobs -- and this is all about j-o-b-s -- and
8 to provide the certainty that businesses need, I
9 wanted to suggest to the Board that a process be
10 adopted to let those businesses know that they can
11 utilize -- gain certainty by utilizing 6596.
12 How you advertise it, how you staff it, to
13 be candid with you, I'm not quite sure. But I do
14 know that taking the uncertainty out of the purchase
15 and the mentality will -- will go a long, long ways
16 to seeing that this regulation is implemented and to
17 once again go after and making those jobs for
18 California.
19 So I just want to throw that out to you.
20 Because my experience has been, you know, we usually
21 get involved after the fact, after someone's done
22 something and then they get audited. And then it's
23 surprise, surprise. That's a 180 degrees from what
24 the Board and the staff and the industry is trying
25 to do here in this situation.
26 Thank you.
27 MS. STEEL: Okay.
28 MS. MANDEL: Ms. Steel.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Yeah, yeah.
2 MS. MANDEL: Do you want us to ask them a
3 question if we have it now?
4 MS. STEEL: Okay. While the other three
5 speakers are coming up --
6 MS. MANDEL: Okay.
7 MS. STEEL: -- Ms. Buehler, you can answer
8 those questions.
9 MS. MANDEL: Okay.
10 Ms. Twomey, you said -- you said employee
11 hours is the one standard that you want to see -- or
12 number of employees, I'm sorry, the additional one
13 that you want to see added. And is that full-time
14 equivalent -- full-time equivalence rather than
15 just, you know --
16 MS. TWOMEY: Absolutely, Board Member
17 Mandel. Yes, full-time equivalence. And
18 the example that, you know --
19 MS. MANDEL: Yeah. Because I just was
20 concerned about, you have some --
21 MS. TWOMEY: Right.
22 MS. MANDEL: -- hot -- I mean, the --
23 your -- the goal, I think, of wages and salaries was
24 to try to get at, you know, how much activity is
25 really happening that's in this category of --
26 that -- that qualifies. And if you just use number
27 of employees, somebody might have a few highly paid
28 people and then a lot, a lot of part-time people,

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 and that's not -- I mean that's -- I guess the
2 part-time people have jobs, but you're really
3 looking for full-time equivalent --
4 MS. TWOMEY: Yes, ma'am.
5 MS. MANDEL: -- full-time equivalence.
6 MS. TWOMEY: Yes. Absolutely. Full-time
7 equivalence.
8 MS. MANDEL: Okay. Thank you.
9 Thank you, Ms. Steel.
10 MS. STEEL: Oh, I thought that CalTax was
11 recommending that employee hours and salaries and
12 wages. So that has to be included part-time, too.
13 MS. TWOMEY: The original -- our original
14 language included the number of employees, employee
15 hours, salaries and wages, capital investment, as
16 well as value of production and units produced.
17 MS. STEEL: Right.
18 MS. TWOMEY: In our review of the industry,
19 we believe that if you were to adopt the number of
20 employees as FTEs, then we would no longer need the
21 employee hours. As well as if you adopted -- and I
22 think staff has already recommended adoption of
23 value production, we would no longer need the units
24 of value produced or number of -- of products
25 produced.
26 MS. MANDEL: But salary and wages is one of
27 the ones in the recommendation from staff.
28 MS. TWOMEY: Yes. Yes.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: And that covers all employees.
2 MS. TWOMEY: That covers all employees.
3 And the reason why we're asking for number of
4 employees is because there are industries that have
5 more sophisticated R&D, and so those are the ones we
6 think of when they're in -- you know, they hire
7 PhD's and white lab coats.
8 But under the NAICS codes, there are also
9 manufacturers that would qualify who do conduct R&D.
10 An example would be a pet food manufacturer; they
11 have R&D in terms of, you know, what's included in
12 the morsel or the -- the pet food. Those aren't
13 white-lab-coated R&D's, but they may have a lot of
14 employees. They may be disqualified if you simply
15 took a look at the salaries and wages. But if you
16 took a look at full-time equivalence based on number
17 of employees, then they conduct R&D and they would
18 be --
19 MS. MANDEL: Right.
20 MS. TWOMEY: -- qualified.
21 MS. MANDEL: Right. So you're trying --
22 you're trying to -- I don't want to use the word
23 "establish." You're trying to ascertain that the
24 establishment, that location, is --
25 MS. TWOMEY: Primarily engaged.
26 MS. MANDEL: -- primarily engaged. And so
27 full-time equivalence is the -- the measure.
28 MS. TWOMEY: Yes. Yes.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: When you're looking at it in
2 that context.
3 MS. TWOMEY: Yes. And the reason we're
4 asking for these different criteria, is because when
5 you look at the statute, the NAICS codes provide for
6 manufacturers of high technology, R&D into, you
7 know, pharmaceuticals and biotechs, pet food
8 manufacturing, manufacturing of asphalt.
9 There's a lot of industries and they're all
10 organized differently, but there are some core ways
11 in which they account for it at both the entity
12 level and the establishment level. So we want to
13 make sure that when the auditors are out in the
14 field, the taxpayers are able to demonstrate their
15 eligibility by providing these records that they
16 keep. They keep records on their operating
17 expenses, on their gross revenue, on their number of
18 employees, employee salaries and wages. And that's
19 how they would be able to demonstrate that they are
20 primarily engaged as a manufacturer or as an R&D.
21 So it's more of an administrative process
22 to make sure that the taxpayer's able to demonstrate
23 to the auditor and to demonstrate that they are
24 eligible under the statute.
25 MS. MANDEL: That most of what they do
26 there is R&D or the manufacturing.
27 MS. TWOMEY: Yes. Yes, that they are
28 engaged primarily in a qualifying activity.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: Okay. Thank you.
2 MS. STEEL: Thank you.
3 Ms. Buehler, could you answer that how to
4 advertise and how to, you know, allocate staff? And
5 that's Mr. Vinatieri's question.
6 And then I guess we have just one more
7 speaker here then?
8 VOICE: Two.
9 MS. STEEL: Oh, two more? Could you come
10 up, please?
11 MS. BUEHLER: With respect to taxpayers who
12 are interested in getting advice specific to their
13 business, we do have information on our website on
14 the manufacturer's specific page, as well as other
15 areas of the web, and included in the special
16 notices and other information that we've been
17 sending out to our taxpayers that indicate to them
18 how to get information in writing from us. We
19 already have seen a number of inquiries coming in,
20 and we do have staff who will respond to them in
21 writing for their request.
22 MS. STEEL: Thank you.
23 So, next speaker is Ms. Nicole Rice.
24 ---oOo---
25 NICOLE RICE
26 ---oOo---
27 MS. RICE: Yes. Nicole Rice with
28 California Manufacturing and Technology Association.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 Just wanted to make general comments of
2 appreciation to the Board and the staff for dealing
3 with this particular and important issue. We're
4 encouraged, as the manufacturer association, about
5 having this discussion, about having a sales and use
6 tax exemption for manufacturing purchases.
7 Given that we are seeing a rise in
8 manufacturing in the country, unfortunately,
9 California's not seeing its share of that
10 investment. So we are encouraged that this move
11 will actually increase that investment, encourage
12 manufacturers to expand and to site here in
13 California. We believe and advocated for the fact
14 that we would want this to be interpreted as
15 liberally as possible so that as many manufacturers
16 could take advantage of this benefit and grow their
17 businesses.
18 And we appreciate the staff's willingness
19 to hear from the industry and our concerns. We also
20 share the concerns that were expressed by CalTax and
21 were encouraged by the movement that was made in
22 that direction. We feel that -- you know, we didn't
23 get as far as we would have liked to have gotten in
24 the discussion, but we are very encouraged by as far
25 as we were able to get in the discussion and we look
26 forward to seeing this implemented and moved
27 forward.
28 Thank you.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Thank you. Next speaker.
2 ---oOo---
3 BILL MATTOS
4 ---oOo---
5 MR. MATTOS: Hi. I'm Bill Mattos, the
6 President of the California Poultry Federation, and
7 I am here with Brian Grant from Foster Farms.
8 Basically, this particular issue we -- we
9 sent a letter in to staff to clarify a "qualified
10 person."
11 You know, when you look at poultry, you
12 think of it as an agribusiness entity, when in
13 reality it's a manufacturing and an agribusiness.
14 And we start with the baby chicks, all the way up
15 through processing. In California we have 20,000
16 employees. We have 103,000 indirect employees, and
17 we have a 22 billion economic engine that runs the
18 state.
19 It's very important that we can compete
20 with the southeast and Arkansas because that's where
21 most of the chickens are raised. And this
22 particular resolution that you're -- you're working
23 on today is something we really like a lot. We have
24 asked staff about qualifying the person in -- in
25 some of our particular businesses within the poultry
26 industry.
27 And Brian is the expert and that's why I
28 brought him. I just -- staff did ask me, and some

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 of the Board Members asked me, to talk about the
2 industry a little bit. We're very competitive with
3 the rest of the nation. Poultry isn't the biggest
4 thing in California because we have 400 agricultural
5 crops. It is the biggest thing in Arkansas and
6 Georgia and Alabama. And so we've got to compete
7 with all those chickens coming in here. And this is
8 one way we can do it, thanks to what you're working
9 on now.
10 So I'll turn it over to Brian.
11 MS. STEEL: Mr. Grant.
12 ---oOo---
13 BRIAN GRANT
14 ---oOo---
15 MR. GRANT: Yes. Thank you. And we -- we
16 appreciate all the work that the Board and the staff
17 has done in clarifying all of these regs. and
18 getting this guidance out.
19 Unfortunately, we do have just one issue
20 with this "qualified person" definition which
21 excludes apportioning trades or businesses. We sent
22 a comment letter in trying to clarify that.
23 Basically, it excludes agricultural
24 business activities. And if you look at the rules,
25 it's -- there's some gray areas in there. And so we
26 just proposed an approach of using the SIC code,
27 major groups, the divisions in there. If you're in
28 the manufacturing SIC code, that's not an

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 agricultural business activity.
2 Unfortunately, I guess with the answer we
3 got back from is that -- that's up to the Franchise
4 Tax Board to -- to define. Because it refers to a
5 Rev. and Tax Code income tax 25128.
6 So we just would like some guidance on
7 this. If we can get something -- you know, if you
8 guys can come up with a ruling, a notice, or
9 something in your Audit Manual that gives us some
10 guidance, we won't have to be back here in five
11 years whenever one of your audit staff looks at this
12 and -- and -- and Appeals staff or whatever, and
13 they will have to make a decision as to what is an
14 agricultural business activity.
15 So that's -- that's what we would like.
16 MS. STEEL: Thank you.
17 Ms. Buehler, how we going to take care of
18 this agricultural businesses?
19 MR. MENDEL: Basically the statute itself
20 specified that the NAICS codes cover that qualify
21 specifically exclude businesses that are considered
22 apportioning businesses under section 25128. Which,
23 as they stated, is a determination that FTB makes.
24 And within 25128, one of the categories
25 that's listed as an apportioning business is
26 agricultural business activity which is further
27 specified to include any stock, dairy, poultry,
28 fruit, fur-bearing animal or truck farm.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 If they can structure their companies such
2 that FTB says that the manufacturing portion of that
3 company isn't an apportioning company, then,
4 provided all the other requirements of the
5 regulation statute are met, they would qualify for
6 the partial exemption.
7 But if FTB classifies them as an
8 apportioning company, we felt that the language,
9 that the statute allowed us no leeway to add
10 something to the regulation that specifically
11 exempted some apportioning company.
12 MS. STEEL: Thank you, Mr. Mendel.
13 I think Michele's sitting here because she
14 has the answer here. So could you --
15 MS. PIELSTICKER: Yes. Michele
16 Pielsticker, State Board of Equalization Leg. and
17 Research Division.
18 I concur with the comments of staff that if
19 in fact FTB were to find that they are mandated to
20 use the three factor apportionment formula in
21 section 25128, that they would in fact be precluded
22 from taking advantage of the sales and use tax
23 exemption on manufacturing.
24 To that end, one option would be a
25 legislative change to the -- to section 6377.1 which
26 would specifically exclude agricultural business
27 activity from being considered an apportioning
28 trader business.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Okay. Thank you.
2 Thank you very much.
3 Any comments?
4 Yes.
5 MR. HORTON: Madam Chair, if I may.
6 We certainly would be willing to explore
7 the interpretation from the Franchise Tax Board. My
8 concern is, is that that, in and of itself, creates
9 a double-edged sword relative to -- to -- to
10 taxation. But we're certainly willing to -- to do
11 that.
12 An interpretation relative to the
13 appropriation might in fact cause problems in other
14 areas of the -- of your filings, Mr. Grant.
15 MR. GRANT: Well, I mean, you know, the
16 Franchise Tax Board may not even look at the issue.
17 It doesn't really impact us. So, if they don't look
18 at it, how is your staff going to come out to audit
19 us? And we're a regular recurring cycle, three-year
20 audit cycle. So they -- they're going to have to
21 make a decision without the FTB.
22 You know, we can file in the appropriate
23 method, as an apportioning trader business or as
24 not, and -- and -- for the manufacturing portions of
25 our ag. operation.
26 MR. HORTON: So it wouldn't matter whether
27 you filed as one or the other?
28 MR. GRANT: Well, I -- you know, I would

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 think your staff, audit staff would still raise the
2 issue and you're going to, you know --
3 MR. HORTON: No, I mean aside from the
4 issue raised by the Board of Equalization, does it
5 matter to the company in and of itself how they
6 file?
7 MR. GRANT: No.
8 MR. HORTON: It doesn't?
9 MR. GRANT: Not for -- you're talking about
10 with the FTB --
11 MR. HORTON: Yes.
12 MR. GRANT: -- and income. No.
13 MR. HORTON: Okay. Then let's seek an
14 interpretation, Madam Chair --
15 MS. STEEL: Yeah.
16 MR. HORTON: -- from the FTB. And at the
17 same time I would certainly encourage that we
18 consider the legislative route as well, and
19 particularly given that the author of the original
20 bill is supportive of broad-based interpretation of
21 the statute.
22 Thank you, Madam Chair.
23 MS. STEEL: Thank you.
24 Member Yee.
25 MS. YEE: Yeah, Madam Chair, I -- I wanted
26 to just dovetail on Mr. Horton's comments.
27 I -- I don't think it's just a simple
28 decision as to kind of your -- how you're going to

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 file or your requirement to apportion your income.
2 I mean, the -- the -- the exemption statute's pretty
3 strict with respect to those entities that have
4 to comply to --
5 MR. HORTON: Restrictive actually.
6 MS. YEE: Yeah, it's actually --
7 And I would think that the remedy, rather
8 than you turning your tax filing kind of on its
9 head, would be to look at a statutory authorization.
10 Because I do think, as Mr. Mattos pointed out, there
11 are probably other vertically integrated operations
12 that aren't going to be able to qualify for the
13 partial exemptions here that we might want to look
14 more broadly at, through legislation.
15 MR. HORTON: I agree.
16 MS. STEEL: Member Runner?
17 MR. RUNNER: Yeah, I don't know how -- some
18 of this, I think, discussion purlieus the issue with
19 Waste Management with regards to what the -- what --
20 how -- trying to interpret the legislation in
21 regards to who's in and who's out.
22 Um, and I guess, you know, my -- my
23 objective would be for us to interpret this as
24 broadly as possible so that the greatest number
25 of -- of industry would be able to benefit that.
26 That certainly is what I interpret the intent of the
27 legislation -- legislature to do, both from what
28 came out of the legislature and what came out --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 what comes out of the Governor's office in regards
2 to a broad benefit process here.
3 The other side of that, I guess, is when
4 they, in the legislation, create restrictions, I'm
5 willing to go as far as we can to -- to -- to
6 give -- to give benefit. But at the same time,
7 we -- if we're restricted, we're restricted.
8 And so I would want to make clear in this
9 discussion if we feel like that we have a
10 restriction, then I think it's -- it's going to be
11 important for the industry to understand how it is
12 that we're going to look at this so that then they
13 can then go ahead and move forward with whatever
14 legislative -- legislative expansion they think is
15 necessary in order to be covered by the -- by the
16 intent of the -- what would be covered by -- by
17 the -- by the -- by the legislation.
18 So I -- I -- I mean, my goal would be --
19 the last thing we want to do is create some kind of
20 a -- you know, some kind of a fog for an industry
21 that all of a sudden doesn't know for sure if
22 they're in or they're out. And I'm a little
23 concerned when it says, well, it's going to be up to
24 our auditor who comes and visits. I don't think so.
25 And so I think that's why I think we need
26 to kind of make sure that we have some clarity in
27 regards to where we're coming from so that then the
28 business then, and industry then, can have clarity

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 as to what their path is.
2 And again, I -- again, my goal would be to
3 make it as broad as possible, but yet we need to
4 understand and restrict what it is that the
5 legislature has -- we -- I would guess, we would
6 think, purposefully put in for some guidance for us.
7 Is that a fair interpretation?
8 MR. MENDEL: It was Legal's interpretation
9 that the apportioning trader business was -- the
10 plain language of 6377.1 was that this was a
11 specific and clear restriction. Whether they
12 intended it to include all of these businesses such
13 as agricultural businesses, the statute didn't
14 include any limitations. It just said if you are an
15 apportioning business under this code section, you
16 are prohibited from using this. And I -- we felt we
17 didn't have any leeway --
18 MR. RUNNER: Mm-hmm.
19 MR. MENDEL: -- in interpreting that some
20 other way as written. If the statute had been
21 written slightly differently, then it would have
22 left us with discretion as far as interpretation.
23 But, as written, we think that the only real viable
24 option is a legislative change because we just don't
25 have any leeway under the plain language.
26 MS. STEEL: Chairman Horton.
27 MR. HORTON: Thank you, Madam Chair.
28 In addition to the restricted language in

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 the legislation, there's also -- at least I also
2 have concern about the -- the legislation
3 discriminating against California companies that are
4 apportioning in such a way because of their
5 existence here in the State of California. Which
6 might be, you know, inverted Cutler case concerns.
7 So it would be incumbent upon us to --
8 to -- to seek a legislative change that brings that
9 clarity that Mr. Runner spoke about. At the same
10 time, we probably, Members, in the legislative
11 process should have the FTB somewhat take a look at
12 this because they may very well be called upon by
13 the legislature to speak to the issue.
14 And given the timeline of this matter
15 relative to the original legislation and the time
16 that it's enacted and becomes effective, I would
17 like to have this put on the Leg. Committee.
18 Some -- to work with the industry and see if we can
19 come up with language or with solutions and with
20 specific direction to the extent that that direction
21 is a legislative change that brings some clarity,
22 that we place that on the agenda for -- the Leg.
23 Committees's agenda for our next meeting so that we
24 can discuss it and possibly take a position as a
25 Board.
26 At the same time, I would encourage the
27 industry to explore opportunities in the legislature
28 to have the language incorporated or amended.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. RUNNER: Yeah.
2 MR. HORTON: And based on what I'm hearing
3 from my colleagues, you'd have a lot of assistance
4 from this body to accomplish that objective.
5 MS. STEEL: Member Runner.
6 MR. RUNNER: I was going to say, to that
7 end, I think your path -- quickest path, and that
8 may be with some others, is -- is in this current
9 budget discussion that's going to come up here in
10 the next couple of weeks. And so I would encourage
11 if there's some -- any other industries that feel
12 like there's an expansion, it seems to me almost the
13 quickest path in order to get clarification.
14 MS. STEEL: Anymore comments, questions?
15 Ms. Yee.
16 MS. YEE: Madam Chair, I'd like to go back
17 to the Action Item Number 2, the definition of
18 "qualified person" --
19 MS. STEEL: Mm-hmm.
20 MS. YEE: -- if I may.
21 Is there anybody from Waste Management here
22 today?
23 Oh, okay. Okay. Are we going to hear --
24 MS. STEEL: Yeah.
25 MR. RUNNER: Yeah.
26 MS. YEE: Okay.
27 ---oOo---
28 CHUCK WHITE

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2 MR. WHITE: Good morning --

3 MS. STEEL: Go ahead.

4 MR. WHITE: -- Madam Chair and Members of

5 the Board. My name is Chuck White. I'm Director of

6 Regulatory Affairs for Waste Management.

7 Our issue does look for further

8 clarification, although it has nothing to do with

9 the Franchise Tax Board's Regulation 25128. But we

10 are seeking some further clarification.

11 Waste Management is the largest collector

12 and processor of post consumer recycled materials in

13 California. We did submit a comment letter on March

14 4th, and for the most part we greatly support the

15 staff's recommendation for the final regulation,

16 with run clarifying exception.

17 The enabling legislation clearly provides

18 that the partial sales and use tax exclusion is for

19 certain NAICS codes of final products. But it also

20 envisions partial sales and use tax for recycling

21 and recycling activities. And unfortunately,

22 there's no NAICS codes for recycling.

23 Our industries' facilities are typically

24 called material recovery facilities or MRFs, and we

25 have a separate NAICS code that's related to other

26 Waste Management services.

27 However, within these MRFs we process

28 glass, plastics such as this I'm holding here

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 (indicating), paper, and metals. And these are all
2 to be processed into feed stocks that are ultimately
3 used by final product manufacturers that are covered
4 by the NAICS codes, but, unfortunately, the
5 recycling materials themselves don't have them.
6 We did have a coalition letter submitted
7 directly to the Board Members last week on April
8 18th. It is a coalition of approximately 90 percent
9 of all of the service providers, both public and
10 provided in California, that collect and process
11 post consumer recycled materials such as these
12 plastic bottles.
13 In addition, CalRecycle, a sister agency,
14 submitted a letter on March 20th to support a broad
15 interpretation of this regulation and to encourage
16 their goal to achieve 75 percent reduction, which is
17 going to require a significant amount of investment
18 in recycling infrastructure. And we think certainly
19 the partial sales and use tax exemption that you're
20 contemplating today for our types of activities
21 within our material recovery facilities would be
22 suitable for inclusion.
23 So our ask for you today is Alternative
24 Number 2, on page 18 of 19 in your Board packet on
25 this item. And again, I have to recognize the staff
26 has been very helpful in recognizing our issue and
27 we certainly appreciate them providing this option
28 for you today for consideration.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 Their language basically says if the
2 activity is covered by a NAICS code, then it would
3 be eligible for this partial sales and use tax
4 exclusion. We're asking for not only activity but
5 also product; like plastic, like paper, like glass,
6 like metals, in a four digit industry group.
7 As an example, the materials that we
8 collect and process within our material recovery
9 facilities, well, glass is one of them. It's
10 sorted, crushed, sized, cleaned and processed into
11 an intermediate product, and it then is sold to
12 other manufacturers for further processing. This
13 falls within one of the NAICS codes industry group
14 3272, glass and glass product manufacturing.
15 Similarly, there's a 3261 for plastics, a
16 31 -- 331X based on the type of metal that was
17 recovered and processed. And finally, 3222 for
18 paper products.
19 So within our MRFs, we have an
20 establishment or an activity that does provide
21 recovered material feed stock that feeds into these
22 other final manufacturing activities.
23 We are fully prepared within these
24 establishments or business units within our MRFs to
25 have separate records and financials be tracking,
26 but we want to be able to qualify for this partial
27 sales and use tax exclusion because we are part of
28 the product chain that feeds these recovered post

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 consumer raw materials into the manufacture of a
2 final product.
3 This will allow our recycling industry that
4 does collect and process post consumer recycled
5 materials to take advantage of this. And we -- all
6 the equipment that we purchase to add value to
7 provide this feed stock into the final manufacturing
8 process would then be eligible for inclusion for the
9 sales and use tax.
10 The height of ironies would be is that a
11 manufacturer of a final product that puts the same
12 kind of equipment that we put at one of our MRFs
13 would be -- if you didn't agree with our
14 interpretation to include this, would be eligible
15 for the sales and use tax exclusion, but the same
16 kind of process at one of our MRFs that does exactly
17 the same thing to make plastic flake or to make
18 glass cullet wouldn't be eligible. So we're asking
19 for a equitable interpretation and delineation in
20 this statute.
21 Finally, this being Earth Day, I would urge
22 you to really support a broad interpretation to
23 encourage the increased recycling in California.
24 Thank you.
25 MS. STEEL: Thank you.
26 I think last speaker, Mr. Ralph Chandler.
27 ---oOo---
28 RALPH CHANDLER

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2 MR. CHANDLER: Thank you, Chairwoman Steel.

3 Yes, my name is Ralph Chandler. I represent and

4 service the Regulatory Affairs Director for the

5 California Refuse and Recycling Council.

6 I should also mention that for ten years I

7 was the Executive Officer to the California

8 Integrated Waste Management Board, a regulatory

9 agency within CalEPA.

10 I -- I -- I'm going to take my two minutes

11 to more or less try to give you a visual of I think

12 what Mr. White did very well in his opening comments

13 about the flow of this material. And if you give me

14 a second, I'm just going to put a few props on the

15 table and then walk you through.

16 What our industry does, again, we represent

17 franchise haulers, recyclers, composters from

18 San Diego to the Oregon border.

19 There's over a hundred million of these

20 plastic PET bottles that are sold in California.

21 You've all utilized them. You may have one back at

22 your desk.

23 When this material is collected by our

24 industry, through curb-side collection programs,

25 drop-off programs, it is then bailed usually to a

26 thousand-pound bale that is at a material recovery

27 facility -- whoops, excuse me -- at a material

28 recovery facility, and then it's taken to an

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 intermediate processor.
2 What that processor does, with very
3 sophisticated and expensive equipment, they color
4 sort it; they separate the green from the clear;
5 they take off the HDPE cap from the PET bottle
6 itself; they shrink it so that the label comes off;
7 the glues come off; and they flake it. They produce
8 a product. This is called clear flake.
9 Once that clear flake is produced into
10 2,000-pound bales, it is then sold to a
11 manufacturer, re-extruded, it's brought to
12 temperature, it comes back to its original molecular
13 form. It's extruded into sheets about the size of
14 the length of this dais, 6,000 pounds in weight. It
15 is then extruded across processing lines to
16 manufacture a new container, primarily for the
17 agricultural industry, where it's then holding
18 your -- your berries. Maybe if you went to Costco
19 you may have seen your apples now provided in these,
20 recycled PET packaging.
21 As Chuck just said, ironically the
22 manufacturer, who now take this sheet and packages
23 that package, qualifies. But the processor who
24 takes the plastic bottle, cleans it, sorts it,
25 flakes it, and readies it into a final form for that
26 manufacturer, does not.
27 We today are here asking that you look at
28 your regulation in a way that would interpret a

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 broad interpretation of this sales and use tax
2 exemption, so that the recycling industry that is so
3 investing in the ability to divert this material and
4 make new package -- because let me just be real
5 clear. Four or five years ago this package was made
6 from petroleum. In other words, it was a derivative
7 of a petroleum. Today it's made out of recycled PET
8 that's reclaimed, processed and remanufactured.
9 We've closed the loop. This right here is
10 pellets. It's the same flake that's then brought
11 through a solid state machine that makes sure that
12 all the volatile's all out and then can be extruded
13 into a new bottle.
14 So we've gone, just like the aluminum can,
15 from bottle to bottle with recycled manufacturing.
16 Again, a very cost-intensive process that does
17 require equipment, sophisticated technology, and we
18 believe that this industry here in California should
19 be afforded the sales and use tax exemption.
20 The last thing I'll say in conclusion is, I
21 represent three facilities; two in Canada, one here
22 in Turlock that just opened up this flake operation
23 four years ago. They are going to build a second
24 plant, and the question is, is it in Mexico, is it
25 in Canada, or is it in California?
26 Decisions like you're contemplating today
27 will have a big influence on whether they choose to
28 site those facilities, invest in California, and

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 hopefully create those green jobs that we know is
2 part of this whole recycling infrastructure.
3 Thank you for your time.
4 MR. WHITE: And if I may just add one minor
5 thing. Our proposed language is basically the same
6 as -- as the staff's, only it adds the term "or
7 products" in addition to "activities," to include
8 these kinds of products that are manufactured.
9 And then we're also suggesting an example
10 be added into that paragraph that clearly provides
11 guidance that these kinds of recycling activities
12 can use a NAICS code for the ultimate manufacture as
13 an establishment within our material recovery
14 facilities.
15 Thank you.
16 MS. STEEL: Thank you, Mr. Chandler to
17 bring all of those items. Thank you.
18 Anymore questions?
19 Chairman Horton.
20 MR. HORTON: Madam Chair, just to the
21 witnesses testifying here today, I notice that some
22 of your props are empty or halfway empty. Is -- was
23 there a reason for that?
24 MR. RUNNER: Close to lunch.
25 MR. WHITE: Mine's not empty yet, but it
26 will be soon. But I plan to recycle it as well.
27 MR. HORTON: I support their position, by
28 the way.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Member Yee.
2 MS. YEE: Thank you, Madam Chair.
3 I guess a question to the staff. Unlike
4 the prior testimony from the poultry association, I
5 find that with respect to the activities that we're
6 talking about here, that we're in a bit
7 straight-jacketed by the industry codes that are
8 specified. And I'm -- I'm wondering if there's a
9 way to get around that. Because I really want to
10 focus on the activity. And albeit we're familiar
11 with the products that are actually manufactured,
12 but it seems to me we have a little bit of leeway
13 here. But did you delve into our latitude in this
14 regard?
15 MR. MENDEL: We -- we basically agree that
16 there is leeway. We -- we don't think -- we don't
17 think adding the word "products" would be
18 appropriate --
19 MS. YEE: Right.
20 MR. MENDEL: -- in relation to the NAICS
21 codes. But looking at the activity, because we have
22 defined an establishment to be based on how the
23 business keeps their own books, as they suggested,
24 if they were to keep their own books that separated
25 out the actual manufacturing activity which is
26 described in one of the qualifying NAICS codes from
27 the materials recovery facilities' activities,
28 there's no third party imposing a NAICS code on a

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 particular establishment.
2 If we were to examine an establishment that
3 appeared to legitimately be within a manufacturing
4 NAICS code and it was separate from the Waste
5 Management -- the materials recovery or the solid
6 waste collection, we think it would be appropriate
7 to find that that was in fact a qualifying activity.
8 We think that it is more appropriate though
9 to address this in the Audit Manual because it's
10 really just an approach to how a business is
11 examined rather than a change to what's already in
12 the regulation. Because the regulation already sets
13 up the establishment cost center approach which is
14 based on how they keep their records. So the tools
15 for qualifying are already there.
16 MS. YEE: So you don't believe the
17 modification has to take place in the regulation
18 itself.
19 MR. MENDEL: That's correct.
20 MS. YEE: Okay. And -- and -- and I'm --
21 one of the other questions I had really had to do
22 with what else, besides Waste Management -- I mean,
23 I guess, we -- conceivably there could be a whole
24 host of other industries, right? So --
25 MR. MENDEL: I mean --
26 MS. YEE: And you think the Audit Manual is
27 really where that gets all addressed?
28 MR. MENDEL: We do because there needs to

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 be guidance to the auditors --
2 MS. YEE: There does.
3 MR. MENDEL: -- how they examine a business
4 that has chosen a NAICS code, to see whether that
5 business legitimately fits within that NAICS code.
6 And in the interest of inclusion, we want the
7 auditors to be liberal. And if it seems like a
8 reasonable interpretation that an establishment does
9 in fact fit within that NAICS code, we would like
10 the audit staff to accept that and move on to the
11 other parts of the regulation.
12 MS. YEE: Okay.
13 MR. MENDEL: We don't want the audit staff
14 taking -- taking too fine a look at whether it's in
15 a qualifying NAICS code or not. We want it to be a
16 reasonable interpretation.
17 MS. YEE: Okay. And -- and -- and I
18 understand that and appreciate that.
19 I guess what I would want to see in the
20 regulation is just some opening to that. Because
21 it's pretty close now, I guess, for lack of a better
22 word. You know if -- if -- if there can be a
23 statement that at least suggests that there could
24 be, you know, qualified person's business activities
25 that could be described by, you know, both a
26 qualifying or non qualifying four digit industry
27 code, that such a person could qualify for the
28 exemption. Just some opening, so that then it's not

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 kind of -- you know, kind of clearly open and shut.
2 It's open, and then further direction to the
3 auditors can then be sought in the Audit Manual.
4 Does that make sense? Because right now I
5 feel like the -- the language that we're suggesting,
6 even though it's -- it's, you know, will not be
7 precluded from "qualified person," I think I'm
8 trying to state it in a more positive way, that
9 there are possibilities that there are others that
10 could fall under qualification for the exemption.
11 MS. STEEL: Okay.
12 Member Runner, then Member Mandel.
13 MR. RUNNER: Yeah, just a quick -- here --
14 here's my concern with doing it that way. And I'm
15 going to come back to the industry in just a minute
16 to see what their thoughts are.
17 But part of the -- part of the objective of
18 doing this was to be able to give clarity and
19 certainty for businesses and business investment.
20 And -- and I'm concerned that if all of a sudden we
21 handle this by putting some notes in an Audit
22 Manual, that that does not provide the kind of
23 certainty and clarity that the industry would need
24 to make business decisions on.
25 And so let me -- let me ask very more
26 specifically in regards to that, what do we believe
27 clearly prohibits us from identifying and adding
28 products to this regulation?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---
2 MR. MENDEL: It seemed that adding products
3 didn't focus on the business --
4 MR. RUNNER: That's not my question,
5 though. What prohibits us from adding products to
6 this definition?
7 MR. MENDEL: -- I don't think we'd be
8 specifically prohibited.
9 MR. RUNNER: Okay, okay, thanks.
10 MS. YEE: Although the statute -- the
11 statute is really focused on activity, so --
12 MR. MENDEL: Yeah.
13 MS. YEE: -- and always the danger of
14 adding products is that you're not being exhaustive
15 or inclusive of everything.
16 MR. RUNNER: Right.
17 MS. YEE: And all I really wanted was to at
18 least acknowledge that there are going to be
19 different types of business activities that aren't
20 captured by these codes that I think are so
21 restrictive that at least say we recognize that and
22 then to clearly continue to give direction to the
23 auditors in the audit manual.
24 And I think that the regulation, at least,
25 should provide that kind of an opening. We've had
26 the discussion here, discussions on the record. We
27 understand with respect to waste management what
28 we're talking about relative to the activities.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 I'm sure there are others out there, but
2 just something in the regulation that at least
3 provides that opening is what I'm looking for.
4 MR. RUNNER: Madam Chair, one of the things
5 I meant to ask, though, when I asked that question
6 was to have the -- the industry respond to that
7 thought too.
8 So, maybe I could -- if we could go back
9 and hear from them based upon my -- thoughts as to
10 what --
11 MR. WHITE: Member Runner --
12 MR. RUNNER: -- they described they could
13 do?
14 MR. WHITE: -- I agree with your concern.
15 We -- we -- we would like to have
16 certainty. And we think just a little bit of
17 additional clarity in this section related to both
18 activities and products will make it clear.
19 You can say recycled products if you want
20 to limit to that, feed into those other types of
21 industries that are specifically included.
22 It's just because we happen to have the
23 recycling equipment, which is clearly covered by the
24 statute. It's just not located at the point of
25 final manufacture. It's pointed -- it's placed
26 upstream from that. And we would just like to make
27 sure that anything we do to feed into a final paper
28 manufacturer, a final plastic manufacturer, a final

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 glass manufacturer would be -- would be certainly
2 included because that was the clear intent of the
3 statute.
4 And we just think that by adding the term
5 "product" or "recycled product" into this would make
6 it clear that these kinds of commodities that are
7 processed into a value-added material that is fed
8 into the final manufacturer would -- those -- that
9 equipment for that purpose would be eligible for the
10 partial sales and use tax exclusion.
11 MS. STEEL: Member Mandel.
12 MS. MANDEL: Thank you.
13 The way -- I mean, I also appreciate that
14 the audit manual is where we give direction to our
15 auditors, but the -- when I was walking into this
16 meeting and I saw the concerns expressed by the
17 recycling industry, I took it as they were looking
18 at something -- for something that would explain to
19 their people, who are the purchasers of equipment,
20 the circumstances under which they might be able to
21 qualify.
22 And while I understand that -- that we're
23 looking for -- in this instance we're talking about
24 manufacturing -- it's sort of the intermediate
25 manufacturing level or preliminary manufacturing
26 level to get the intermediate product -- that --
27 that -- that -- that the man on the ground, the man
28 or woman on the ground at the recycling

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 establishment, who may not be the giant waste
2 management, but that all of the people in the
3 industry who might have this equipment and be doing
4 these things, that they could look at the regulation
5 and whatever outreach material we later come up with
6 and understand, "Oh, hey, I make that thing. I
7 could probably qualify for this."
8 So, I kind of took their suggested
9 language, including their example, as -- that they
10 were trying to find a way so that -- so that the
11 people in the industry who were -- who -- you know,
12 who were doing this would all understand.
13 You know, when I look at the those NAICS
14 codes, it looks like some of it's talking about if I
15 do something in a particular product category or
16 product group, I'm doing that activity.
17 And I think that's why we look at as it's
18 sort of descriptive of an activity -- that I'm
19 doing stuff with glass, for example. And I fit
20 under that NAICS code.
21 Because you're still saying, if you're
22 doing something that's under that NAICS code, that
23 NAICS code is in the statute, you're okay.
24 I -- now I am repeating myself, but I -- I
25 took their language as a way of trying to educate
26 people in the industry that say, "Hey, you might
27 think, you know, your -- you might know or not know
28 what NAICS code you're in, but, by the way, if

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 you're -- if you're making -- if you're making a --
2 a product -- 'cause goods are things you sell,
3 products are things you make -- maybe the language
4 is too, you know, soft for you, I don't know, but
5 that -- that it was really an education effort.
6 That's kind of how I took it. That it was
7 so that somebody would be able to look at the reg
8 and say,
9 "Oh, yeah, I make stuff. I make
10 -- I make something that I sell to
11 somebody else."
12 So -- "And when I make it, I'm under this
13 code."
14 Where staff would say,
15 "Well, when you're making it
16 you're under that code because that's
17 your activity."
18 That's how I understood the staff view of
19 "activity."
20 Is that -- am I making sense to you?
21 MR. MENDEL: I --
22 MS. MANDEL: I think I'm making sense to
23 them, but I'm not sure if I'm making sense to you.
24 MR. MENDEL: I -- I mean, the -- the way
25 the NAICS codes are broken down are subgroups, as
26 you pointed out, that are often subgroups based upon
27 the product -- that there's a whole section of paper
28 or a whole of various metals, a whole section of

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 four-digit NAICS codes for glass manufacturers and
2 so on and so forth.
3 So, the products -- the product you are
4 dealing with is sort of a subcategory of the
5 activity within those NAICS codes.
6 But I think the key distinction, the way
7 we're looking at it, is that the flexibility is
8 built into the establishment definition.
9 And perhaps if we added some clarity that
10 the application of the NAICS code will also be based
11 on the establishment definition that that would
12 allow the business to have clarity.
13 Because the primary problem we're coming up
14 with against the recyclers is there is a specific
15 six-digit NAICS code covering the material recovery
16 centers.
17 And, so, if they did not segregate their
18 books, but came to us as an entity, we would have to
19 take that into account and look at whether or not
20 they were, in fact, under the reg primarily engaged
21 in a manufacturing activity as opposed to primarily
22 engaged in a waste management recovery center
23 activity.
24 And I'm wondering if the clarity shouldn't
25 be so specific to the recycling industry, but should
26 just clarify that the application of the NAICS code
27 will be based on the activities being conducted at
28 the establishment as defined.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: Well -- and then -- I don't
2 want to be rude, let's see -- but it -- because the
3 comments came in and because they were asking for an
4 example, I really took that as if this thing -- and,
5 you know, you guys did put in something that you
6 thought covered them by the activities and if you're
7 not in one of these generally, but you're in this
8 other thing, you just didn't pick up products and
9 you didn't pick up the example 'cause you thought it
10 could be confusing that there might be some
11 operators out there who who are recyclers but
12 wouldn't ever qualify under one of those four-digit
13 codes.
14 I thought that was a little extreme just
15 because it said, "qualifying four-digit code." So,
16 you could change the example to actually list the
17 four codes, but I took the whole thing as -- as
18 indicative that at any level there would need to be
19 specialized outreach to this industry because
20 they've clearly identified situations where if they
21 set them -- set up their books for the establishment
22 level, if they have both things going on in one
23 place, that they could -- even staff agrees they
24 could qualify.
25 And it's a question of how to make sure
26 that they -- and, I guess what I'm hearing also from
27 here is perhaps there's other industries where there
28 are similar situations, where someone could qualify

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 if they only knew exact -- knew -- knew how or
2 understood that it's -- it can come down to a
3 smaller level if they keep their books and records
4 that way.
5 MR. MENDEL: That was why I was suggesting
6 that maybe rather than just a specific clarification
7 regarding recycling, we add clarification that the
8 application of the NAICS code is based on the
9 establishment as defined, based on the cost center,
10 how you keep your books.
11 MS. MANDEL: Okay. But we would still have
12 to do some --
13 MR. MENDEL: Yeah --
14 MS. MANDEL: -- I mean, I'm not familiar
15 with recycling guys, so, I don't want to diss them
16 them or anyone else in terms of reading the reg.
17 But we'd still have to do -- if we did that
18 we'd -- you -- I mean, we're going to have to do
19 outreach so that people can comply.
20 But, anyway, that's how I kind of took
21 it.
22 MS. STEEL: Chairman Horton.
23 MR. HORTON: Thank you, Madam Chair.
24 Possibly we can do all three, you know, or
25 both.
26 We can have further clarification in the
27 FAM and in the -- as Member Yee has recommended --
28 in the regulation itself it's not uncommon to have a

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 Section A that sort of speaks to the general nature
2 of the regulation and then a Section B that gets
3 more into the specifics of transportation and when
4 it occurs and so forth and so on.
5 A little concern about the -- using the
6 language "product" as versus "activity" or both.
7 One "activity" is much broader. If you
8 define that activity, the product -- the product
9 itself begins to narrow the interpretation from an
10 auditor's perspective. And, so now, all of a
11 sudden, you are kind of in the -- in -- in the
12 situation that the Board finds itself when you're
13 talking about medicine -- coming up with a huge list
14 of medicines and products and so forth and so on.
15 And therein again creates inherent challenge, I
16 think, for the auditor.
17 But if we stay consistent with the statute,
18 "activity," and provide the specific language in the
19 regulation, subsequent to the general language, I
20 think we get there.
21 The auditor has clarity. And then that, as
22 Member Yee has indicated, serves to cause the
23 auditor to go to the F -- FAM, Field Audit Manual,
24 for specifics or even more detail.
25 And I think you accomplish your objective.
26 MR. WHITE: All we're asking for is just
27 certainty so we know what -- what kind of equipment
28 would be eligible for the sales and use tax

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 exclusion.
2 And we'd be happy to work with Board and
3 staff. And our preference would be to include
4 products because, you know, if -- if it's just the
5 activity, glass and glass product manufacturing
6 activity, well, we're not the final manufacturer or
7 an intermediary or even an initial manufacturer of a
8 feed stock that goes into that.
9 As long as it's clear that that entire
10 process, that product training leading up to the
11 final manufacture, is eligible for the sales and use
12 tax inclusion, that would be great.
13 We're not looking for the sales and use tax
14 exclusion for our entire material recovery
15 facility -- it's just for that specified equipment
16 that is used to further process and manufacture
17 paper, glass, metal and plastics into a -- into the
18 final product.
19 MR. HORTON: Madam Chair, if I may?
20 The activity that you define can be defined
21 in the -- in the regulation, which will be inclusive
22 of -- of the -- of the process that was articulated,
23 melting it down, dah, dah, dah, dah, in Step 2, Step
24 3, Step 3 (verbatim).
25 That is an activity. It's just an activity
26 that happens to be in the recycling industry, but
27 it's an example that would provide clarity to the
28 auditor.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 I mean, as an auditor of 25 years, if I saw
2 a product in there, it's going to be exclusive in my
3 mind. I mean, if I don't see -- if I don't see your
4 specific product, it's going to get picked up and
5 then, all of a sudden, it's going to go through a
6 process and you end up in the Appeals process.
7 And maybe sometime later it's resolved by
8 the Board as, okay, this is what we meant from the
9 beginning, when we could have sort of clarified it
10 in the beginning.
11 So, I think in addition to -- in addition
12 to providing clarity for the industry, we also want
13 to provide clarity for the auditor, the audit
14 process and all of those that you'll be buying
15 equipment from as well.
16 And then, as well, we don't want the
17 unintended consequences that could occur when we
18 start getting into delineating various different
19 products.
20 It's almost like when we start mentioning
21 names and trying to say thank you, we inadvertently
22 are going to leave somebody out. And it's probably
23 our closest friend, but --
24 MR. WHITE: We're happy to work with you on
25 that.
26 And we can work on language. We wanted to
27 include product because, for example, glass and
28 glass product manufacturers, if to the extent that

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 we're providing a product that feeds into that final
2 manufacturing process, glass, glass cullet, we want
3 to make sure that the unit that produces that glass
4 cullet would be eligible.
5 That's why we wanted to have both the
6 activity or the product if that product is
7 specifically identified in an ultimate NAICS code,
8 such as glass and glass product manufacturing or
9 plastic and plastic product manufacturing or metal
10 or paper.
11 MR. HORTON: But an activity that is
12 inherently part of -- of a manufacturing process
13 from the -- from the beginning to the end,
14 basically, without, you know, using the language,
15 includes everything.
16 MR. WHITE: If we can -- if we can make
17 sure that's clarified in the final rule, I think
18 we'll be happy.
19 MR. HORTON: And it's -- it's --
20 MS. MANDEL: Okay.
21 MR. HORTON: -- I mean, again, I think it's
22 safer from the auditor's perspective.
23 You know, I -- you put "product" in there
24 you're going to -- you're going to end up with some
25 dispute at the audit level -- unless it's clear,
26 unless we say product, waste management and so forth
27 and so on.
28 And to some extent, we -- we're being

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 redundant and redundancy as always brings about
2 confusion.
3 MS. BUEHLER: So --
4 MS. STEEL: Member Mandel.
5 MS. MANDEL: -- oh, I'm just wondering when
6 we would be able to -- how would we effect getting
7 that working together and getting the language for
8 us?
9 MS. STEEL: I think the staff has a lot of
10 issues here, that one clarification, especially
11 business wanted, because when you make it too broad
12 and just not specific, then they might not going to
13 be eligible to, you know, go into this -- you know,
14 the exemption.
15 And then, at the same time, that we have to
16 think about the -- the industry later, that other
17 industries coming up that we have to have little
18 open to include those industries later on.
19 So, we have two, three issues here. One,
20 clarification that for recycling, how you going to
21 language that?
22 I think you have to work with the industry
23 itself and then, you know, bring it back -- bring
24 back.
25 Chairman?
26 And let me just finish the thought -- and
27 then second thing is that those other industries
28 coming up later, that what Member Yee was concerned.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 So, I think there is at least like two at
2 this point.
3 And Chairman Horton.
4 MR. HORTON: Thank you, Madam Chair.
5 I just pulled up a -- a regulation that we
6 had similar issues with years ago -- I won't say
7 'cause it would kind of tell my age and
8 affiliation -- but Regulation 1802, it says -- which
9 deals with the place of sale and used for purposes
10 of Bradley-Burns, which is really, really
11 complicated and confusing at times.
12 It goes in and it says -- generally
13 speaking when it talks about retailers having a
14 business, place of business and so forth and it
15 covers the general statement.
16 And then it goes on within the same
17 regulation, Section B, to say, "place of sale in
18 specific incident." And it talks about vending
19 machine operators. It talks about retailers.
20 Examples of the activity that would be included.
21 So, I think we can accomplish the -- the
22 consensus of the Members in support of the efforts
23 to bring that clarity, Madam Chair, as the
24 regulation comes back for our approval.
25 MS. STEEL: Sure.
26 MR. RUNNER: Just to --
27 MS. STEEL: Any --
28 MR. RUNNER: -- I've got a quick question

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 in regards to timing.
2 Part of our issues are a timing issue,
3 right? We don't -- we -- we have a July 1st
4 deadline.
5 MS. BUEHLER: Yes.
6 MR. RUNNER: That -- that all of us -- if
7 we start missing times and asking you to come back,
8 we're going to miss the July 1st deadline, correct?
9 MS. BUEHLER: Yes.
10 MS. STEEL: If you come back next month?
11 MR. RUNNER: Yes. Right?
12 MS. BUEHLER: Yes.
13 MR. RUNNER: So, I mean -- this is -- I
14 think so.
15 Part of our problem is we -- I mean, I
16 think you need us to come to conclusion today in
17 order to make your July 1st deadline.
18 MS. BUEHLER: That would be ideal.
19 MR. RUNNER: Well, I mean, not ideal.
20 Let me ask if it -- if we don't do it
21 today, do you -- are you able to make July 1st
22 deadline?
23 MS. BUEHLER: I don't think we'd make a
24 July 1st deadline. I'd have to check back with
25 staff on the calendar.
26 But we would, in essence, have something
27 for industry to take a look at because it would have
28 been approved, in theory, in the Board meeting in --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 in May, if we went that route, that they'd have
2 something there. But it still -- it has to go
3 through OAL and all the other processes as well.
4 MR. RUNNER: And I'd like -- I guess I
5 would be concerned and interested in hearing from
6 industry how they would feel about us just having
7 some broad discussions, but not meeting the deadline
8 in regards to what that does for the industry in
9 general.
10 I think they'd be concerned about that.
11 MS. STEEL: Okay, Members, so can we just
12 support the waste management today and then staff
13 can come back later for other language changes?
14 MS. MANDEL: Well, can I ask a question?
15 MS. STEEL: Sure.
16 MS. MANDEL: Is the -- is the plan for
17 the -- for July 1 a regular -- is it an emergency
18 reg or is it going to be a regular public hearing
19 reg? Or what are you trying to do by --
20 MS. BUEHLER: It's my --
21 MS. MANDEL: -- July 1?
22 MS. BUEHLER: -- understanding it's a
23 public hearing reg.
24 MS. MANDEL: So, you're not going to -- you
25 are not going to have -- and you were thinking a
26 public hearing?
27 I mean, I don't know that you'd be through
28 the whole process and the whole OAL process by

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 July -- July 1.
2 MS. BUEHLER: No, we won't be through OAL
3 by July 1.
4 MS. MANDEL: So -- and is it the sort of
5 regulation that could be adopted as an emergency
6 regulation or -- well, I am just -- the focus on the
7 July 1, just --
8 MR. MENDEL: I'm not sure it's what we
9 would normally consider an emergency regulation.
10 MS. MANDEL: Okay, I don't know those
11 rules.
12 MR. MENDEL: I don't --
13 MS. MANDEL: I can't help.
14 MR. MENDEL: -- the emergency reg rule
15 off --
16 MS. MANDEL: Okay.
17 MR. MENDEL: -- the top of my head.
18 MS. MANDEL: So, your -- your plan was to
19 try to hold a public hearing prior to July 1 so that
20 i was on its way to OAL or just get the notice out
21 before July 1?
22 MS. BUEHLER: The notice would definitely
23 be going out before July 1 as far as notice to
24 taxpayers or special notice, all that information
25 would be going out based on what we knew from the
26 Board hearings and the regulation that had been
27 approved here.
28 MS. MANDEL: Well, I meant the reg -- the

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 regulatory hearing, the public hearing -- was that
2 anticipated?
3 I don't -- maybe that's in here somewhere.
4 Was that anticipated to be before July 1?
5 MS. STEEL: What's the timeline here?
6 MS. BUEHLER: I need to check with staff.
7 MS. STEEL: Just --
8 MS. MANDEL: With the --
9 MS. TWOMEY: If I may provide some clarity
10 to answer some of the questions that the Board
11 Members have raised?
12 The statutory language provides for the
13 implementation of the manufacturers' exemption
14 beginning July 1, 2014.
15 As it stands now, based on my conversation
16 with BOE staff, it doesn't look like we're going to
17 get those regulations until, at the earliest, the
18 middle or end of September. So, that's several
19 months already down the line.
20 We would urge the Board to take action
21 rather than delay, because with the regulations it
22 provides more certainty to taxpayers.
23 If we delay the process any more, we may be
24 going forward, you know, into possibly October or
25 November without a regulation.
26 And please keep in mind that, you know,
27 this is on an eight-year project only, to the
28 exteent that taxpayers lose six months or eight

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 months without certainty, that's going to impact
2 the -- their business operations, the amount of
3 economic activity that's generated by, you know, the
4 purchase of this equipment.
5 And, you know, it would then dilute the
6 intent and the effectiveness of the legislation.
7 MS. STEEL: Thank you very much for the
8 clarification.
9 Okay.
10 MS. WHITAKER: Good morning, I'm Lynn
11 Whitaker with the Business Taxes Committee.
12 And I do have the estimated approval of
13 regulations. If the Board authorized pub --
14 publication of the regulation today, we would expect
15 a public hearing date of July 17th -- at the
16 July 17th Board meeting -- and publication -- OAL
17 publication on May 23rd.
18 If the Board waited to the next -- to the
19 May 22nd Board meeting to authorize publication of
20 the regulation, we would expect OAL publication to
21 be June 20th. And that the public hearing to be at
22 the August 5th Board meeting.
23 MS. MANDEL: So, it's basic -- it's
24 basic -- essentially a two-week, two and a half
25 week --
26 MS. WHITAKER: Change in the public hearing
27 date.
28 MS. MANDEL: -- change in the public

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 hearing date.
2 MR. RUNNER: Can I just -- procedure wise?
3 If we have a public hearing and at that public
4 hearing we wish to change some language at that
5 public hearing, what does that -- what does that --
6 what does that construct do?
7 Does that create -- can we -- does that
8 start the process again? Or do we -- do we
9 actually -- can we adopt -- can we change some --
10 MR. MENDEL: I think --
11 MR. RUNNER: -- tweak language and still
12 stay on schedule?
13 MR. MENDEL: -- I think it depends on
14 the -- on the nature of the change.
15 MR. RUNNER: Okay. So, for instance, we're
16 pretty -- this is a pretty narrow, specific issue
17 we're talking about.
18 So, if we moved forward today and -- and --
19 and used some language that was maybe looked at
20 as -- as maybe -- I mean, I had some interest --
21 thoughts in regards to whether or not when you add
22 products to activities, you actually are narrowing.
23 It seems to me when you use the word "or"
24 you are -- actually are expanding. But -- but if we
25 use the word "products" there now, as the suggestion
26 is, and then -- and that's -- and there still can be
27 dialogue going on. And that could be further
28 refined at our public hearing and we could still

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 stay on schedule?
2 MR. MENDEL: I think if it's merely a
3 refinement of the language that's there --
4 MS. WHITAKER: It's substantially related,
5 I think it would go a 15-day file.
6 MR. MENDEL: -- it's basically whether it's
7 a substitute change or not.
8 I think if it's a refinement of the
9 language, it may not be considered a substantive
10 change.
11 MR. RUNNER: I mean, clearly we're all
12 trying to get there, right?
13 I mean, there's no doubt everybody is
14 trying to get there and we just are trying to find
15 the right language to get there.
16 So, again, I don't -- I'm not sure how we
17 can find it as substantive if it's just trying to
18 clarify this really fairly narrow discussion.
19 MR. MENDEL: I think if we added it as an
20 example or something like that, it would fairly
21 clearly not be a substantive change because it would
22 simply be adding an example to the language that was
23 there.
24 MR. HORTON: There you go, problem
25 solved.
26 MS. STEEL: Okay.
27 MR. RUNNER: Okay.
28 MS. STEEL: Okay. So, I guess we all

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 agreed that we going to vote today.
2 So, you want us to -- to make a motion for
3 all -- each items, thank you very much, first.
4 MR. CHANDLER: Thank you.
5 MS. STEEL: Okay. Action 1, I need the
6 motion, Members.
7 MR. RUNNER: These are the consensus items?
8 MS. STEEL: Yeah.
9 MR. RUNNER: Correct?
10 So moved.
11 MS. YEE: Second.
12 MS. STEEL: Okay. Member Runner moved and
13 second is by Member Yee. And it's been passed.
14 And for the second -- for action item 2,
15 waste management recommendations, as is now and then
16 maybe -- maybe we can add -- you know what, before
17 we do that action 1, that we have to do the
18 legislative change for the poultry and the
19 agricultural businesses.
20 So, that's going to move to Legislative
21 Committee.
22 Is that okay, Mr. Chairman?
23 MR. HORTON: Yes, thank you --
24 MS. STEEL: Okay.
25 MR. HORTON: -- Madam Chair.
26 MS. STEEL: Now --
27 MR. MENDEL: Excuse me?
28 MS. STEEL: Yeah?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. MENDEL: I'm sorry to interrupt, I'm --
2 I may not have been correct in saying that adding an
3 example isn't necessarily substantive.
4 MS. MANDEL: Did you hear from Mr. Heller?
5 MR. MENDEL: Yes
6 MS. YEE: Can I make a suggestion?
7 MS. STEEL: Yes.
8 MS. YEE: On the -- on the suggested
9 language now, what if we inserted the word
10 "reasonably" before "described"?
11 So, that kind of gives us the opening and
12 then the example can kind of point back to that?
13 MR. RUNNER: Where would you insert
14 "reasonably"?
15 I'm sorry.
16 MS. YEE: Let's see, I'm trying to -- hold
17 on one second.
18 MR. MENDEL: "Six digit NAICS code to
19 reasonably describe their line of business."?
20 MS. MANDEL: I'm on -- I'm on page -- I
21 just found it here, I'm on page 18 of 19 where it
22 has Alternative 1, staff recommendation;
23 Alternative 2, regulatory by waste management.
24 Is that side by side?
25 MR. MENDEL: Yeah.
26 MS. MANDEL: Okay. So, you're in column 1,
27 Alternative 1, staff --
28 MR. MENDEL: Right.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: -- staff recommendation?
2 Sort of -- one, two, three, four, five --
3 the -- the fifth line up from the bottom? Is that
4 where you are?
5 MR. MENDEL: Yes.
6 "When there is no app --
7 applicable six digit NAICS code to
8 reasonably describe their line of business
9 or that are reasonably described in the
10 qualified four-digit industry codes."
11 MS. YEE: Yeah, the -- the latter.
12 MR. MENDEL: Okay.
13 MS. YEE: "Are reasonably described."
14 And that way --
15 MS. MANDEL: So, that's the third line up?
16 MR. RUNNER: If --
17 MS. MANDEL: Okay.
18 MR. RUNNER: -- if we did that and we added
19 an example --
20 MS. YEE: Yeah, I was trying to not have
21 the example be considered substantive.
22 MR. RUNNER: Right.
23 MS. YEE: This, at least, kind of
24 broadens --
25 MR. RUNNER: If we did that and then
26 instructed to add an example --
27 MS. YEE: Right.
28 MR. RUNNER: -- in the recycling issue?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. YEE: Yes.
2 MR. MENDEL: Let me -- apparently if -- the
3 standard is whether it changes the substantive
4 meaning of the current language, which is obviously
5 incredibly gray.
6 But I think if we make it -- make some
7 change today, that an example that is clearly within
8 that change isn't going to necessarily change the
9 substantive meaning.
10 MS. YEE: That's what I'm striving for.
11 MR. MENDEL: Uh-huh.
12 MS. YEE: Okay.
13 MS. STEEL: So, Member Yee, motion?
14 MS. YEE: So, I would move, let's see, for
15 action item 2 I would move the staff alternative
16 with the modification just described, inserting the
17 word "reasonably" to modify "described in a
18 qualified four-digit industry group," and include an
19 example that reflects the waste management concerns.
20 Does that make sense?
21 MR. MENDEL: An example regarding the
22 pre manufacturing of recycled material?
23 MS. YEE: Yes.
24 MR. RUNNER: Second.
25 MS. STEEL: Any objections?
26 MR. RUNNER: Let's hear some comments from
27 the industry.
28 MR. WHITE: You know, just -- this is Chuck

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 White again with Waste Management.
2 You know, we would be willing to strike the
3 word "product" from our request if you include our
4 language with respect to the example.
5 And if you just go with that today, we will
6 live with it, I think -- depending on what the final
7 language looks like, just -- just to resolve this
8 impasse.
9 Because we think right now, given the
10 discussion we have heard today that, clearly, the
11 intent would be to grant exclusion to these kinds of
12 activities.
13 We'll drop our request for the word
14 "product," but if you could include that example, I
15 think that would give us -- provide adequate
16 guidance for us.
17 MR. RUNNER: I think Member Yee's motion
18 accomplishes that.
19 MR. HORTON: This is the -- Madam Chair, if
20 I --
21 MS. STEEL: Yes.
22 MR. HORTON: -- if I may add?
23 I just wanted to put some language out
24 there for consideration after lunch.
25 It's,
26 "The manufacturing activity shall
27 include the process of tangible personal
28 property that is intended to be used in the

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 manufacturing product by a qualified person
2 as defined as a qualified person, pursuant
3 to (inaudible)."
4 Which is basically what you do without
5 saying what you do.
6 MS. MANDEL: That might have been too fast
7 even for the court reporter, but I'm sure you --
8 MR. HORTON: Okay, I can restate it.
9 Let's see if Legal can kind of mull that
10 over.
11 And incorporating such language I think
12 accomplishes the objective as -- and is broad enough
13 to include everyone that is a step in the process or
14 condition subsequent to the actual action as defined
15 by the statute.
16 MR. RUNNER: Is that a substitute motion?
17 MR. HORTON: No, I'm just mulling it over
18 and --
19 MS. STEEL: So, Member Yee?
20 MR. HORTON: -- I mean, I'd like to have
21 legal counsel -- give us advice, if you will.
22 MS. YEE: Maybe, Madam Chair --
23 MS. STEEL: Can we just get the clear
24 language after lunch?
25 MS. YEE: -- yeah.
26 MS. STEEL: And then, you know --
27 MS. YEE: It's just --
28 MS. STEEL: -- bring it back to us?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 So, the solution --
2 MS. YEE: Yeah.
3 MS. STEEL: -- is going stay or just pass
4 it and then?
5 MS. YEE: We could --
6 MR. HORTON: I'd recommend that we put it
7 over until after --
8 MS. YEE: -- yeah.
9 MR. HORTON: -- after --
10 MS. YEE: Recess.
11 MS. STEEL: Okay. Let's just put it over
12 and then --
13 MR. HORTON: Reconvene?
14 MS. STEEL: Yes.
15 And then we have third item here, right?
16 MR. RUNNER: Yes.
17 MS. STEEL: Cal-Tax recommendations.
18 MR. RUNNER: Do we need a motion to put it
19 over?
20 MS. STEEL: A motion?
21 MS. YEE: No, she can just do it.
22 MS. MANDEL: You want to take up the third
23 item?
24 MS. YEE: You want to do action No. 3?
25 MS. STEEL: Yeah, third item.
26 MS. MANDEL: Oh, okay.
27 MS. YEE: So, on action item No. 3, I would
28 move to adopt the staff suggested language.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. HORTON: Second.
2 MS. MANDEL: Oh.
3 MR. RUNNER: And -- okay, I'll -- okay.
4 And not -- and not expand the issue of
5 number of employees?
6 MS. YEE: No. I mean, I actually thought
7 that what, staff did relative to adding the two
8 additional alternative tests really covers a lot of
9 ground.
10 And -- and, frankly, among all of the
11 criteria I thought number of employees was the least
12 compelling to me because we're looking at, you know,
13 kind of this primarily engaged requirement that I
14 think you capture through wages and --
15 MR. RUNNER: Let me --
16 MS. YEE: -- the value of production.
17 MR. RUNNER: -- let me just ask and follow
18 up on staff and there are some question there.
19 Again, these are different tests that are
20 going on. So, this is trying to identify who -- you
21 know, that -- how -- how -- what -- how this is
22 going to be determined.
23 If the industry is thinking that it's --
24 there might be some who lose out, if we don't
25 include this.
26 MS. STEEL: Member Runner, can we bring
27 Ms. Twomey back?
28 MR. RUNNER: Yeah, that'd be good.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Yeah.
2 MR. RUNNER: My concern would be if we --
3 if we -- if we have industries who might feel like
4 they could miss out on this, based upon this number
5 of employee calculation, why wouldn't we --
6 what's -- what's the harm with going to the number
7 of employees?
8 I mean, just ask staff that real quick.
9 MS. MANDEL: And it's full-time equivalent?
10 MR. RUNNER: It would -- and that would be
11 full-time equivalents, correct.
12 What -- what's the harm in doing that?
13 MR. MENDEL: It would just be a matter of
14 whether we were then picking up industries that
15 weren't actually primarily engaged in one of these
16 activities simply because of a head count, that they
17 had a lot of employees doing this, but that looking
18 at any of the other standards that wasn't really
19 what that establishment or entity was primarily
20 engaged in.
21 MS. STEEL: But what's --
22 MR. RUNNER: That is the second --
23 MR. MENDEL: It's just very artificial.
24 MR. RUNNER: -- isn't that the second part
25 of the test, though?
26 Well, maybe we could have --
27 MS. STEEL: Yeah, Ms. Twomey.
28 MR. RUNNER: -- industry --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. TWOMEY: You're absolutely right,
2 Senator Runner, in the sense that we feel that if
3 the number of employees was excluded from a
4 measurement to demonstrate qualification that there
5 would be taxpayers who qualify under the statute who
6 would then be disqualified or precluded from the
7 partial exemption under the regulations.
8 And, you know, one example would be an
9 R & D company who starts out in its first year. We
10 have acknowledged that, you know, the staff does not
11 want to include capital investment. So, capital
12 investment would be excluded for purposes of
13 measuring "primarily engaged."
14 As an R & D company, they would be excluded
15 from the gross revenue test because R & D companies
16 do not directly produce revenue.
17 So, as an alternative to replace the -- you
18 know, that gross revenue test for R & D companies,
19 if you take a look at the first year, they have
20 capital investment. They don't have a lot of, you
21 know, operating expenses because they may only have
22 operations that are in six months of that particular
23 fiscal year. And we're looking at a fiscal year
24 basis. They will not have staff on board for, you
25 know, a full year, they'll only have staff on board
26 for six months. So, they would not qualify under
27 the salaries and wages test.
28 But if you take a look at their FTB -- the

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 FTB -- the amount of employees that they have
2 dedicated to that particular function, that is a
3 qualified function, would then allow them to prove
4 their qualification. If you look at them, they
5 would be engaged in manufacturing or R & D.
6 But if you don't count the number of
7 employees, then you're actually discriminating or
8 disadvantaging those different industries that may
9 not have highly paid or may not have a full year's
10 worth of salaries and wages in which to demonstrate
11 their qualification.
12 MR. HORTON: Madam Chair?
13 MS. STEEL: Yes, Chairman Horton.
14 MR. HORTON: You know, I'm sensitive to
15 this, but, you know, the concern is -- is --
16 is typically, you know, not typically, but sometimes
17 when you start out in research and development, you
18 actually don't have the a number of employees to --
19 to meet any test.
20 You start out with a capital investment.
21 You start out with your research team doing the
22 research and so forth. And I've seen these items
23 disallowed and yet then they come before the Board
24 because of the lack of understanding of the initial
25 process of the research and development process.
26 So, when you -- it's a double-edged sword
27 when you include a variable. Certainly there are
28 those who would have in excess of 50 percent.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 But if they have in excess of 50 percent,
2 particularly when you're using the full-time
3 equivalent, you're going to get into the dollar
4 factors because the labor factor is generally tied
5 to gross receipts, generally tied to other
6 activities as well, from just an accounting
7 perspective.
8 But on the -- on the opposite side, where
9 it could have a negative impact is when you have
10 companies that are participating in research and
11 development and they have yet to get to the stage
12 where they're actually employing a lot of
13 individuals to accomplish that objective. They're
14 really in the initial phase of the R & D.
15 MS. TWOMEY: Most of the R & D are not so
16 much, you know, manufacturing equipment or
17 equipment, more of their operating expenses are for
18 the people who actually do the work.
19 And, once again, if we don't take into
20 account the number of employees, then you would be
21 disqualifying or discriminating against those
22 companies that use more sophisticated, higher level
23 expertise for R & D versus those that use lower
24 level.
25 So, with a more sophisticated R & D project
26 where they're doing, you know, genetic testing or
27 recombinant genetic, you know, genes and they're
28 looking at that, they will have Ph. D.s and

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 scientists who are paid at the higher level who
2 would qualify under the salaries and wages test.
3 But in an example where they're doing less
4 sophisticated R & D, they're not going to have the
5 Ph. Ds. They might have one scientist, one
6 professor, a couple of professors and a whole bunch
7 of graduate students engaged in the area. And they
8 will not be paid at that higher level. So, they
9 would be disqualified if the number of employees is
10 not a factor in determination.
11 And, furthermore, elsewhere in the
12 regulations the staff has acknowledged that the
13 number of employees is a viable factor in
14 measurement of the regulations. It's included in,
15 you know, several -- I think in at least --
16 mentioned in two areas that this is an acceptable
17 measurement of, you know, activity in a qualifying
18 NAICS code.
19 And, so, that's why we thought, you know,
20 it should be comprehensive as well as it should be
21 comparable if you are going to measure an
22 establishment and identify it as a measurement that
23 you should also be able to measure it on the other
24 side for primarily engaged as well.
25 MR. HORTON: Madam Chair, if I may?
26 MS. STEEL: Yes.
27 MR. HORTON: For professional judgment
28 purposes I would concur. And probably the reason

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 why it's included elsewhere to have a determinative
2 factor that, in fact, could determine whether or not
3 you're excluded, I would go to -- I would be very
4 much concerned about those who would be -- who would
5 be excluded as a result of this.
6 In the -- is there -- is there a specific
7 example or some place in history where we've had
8 this challenge?
9 I mean, my recollection of it just doesn't
10 -- it seems to be more of a challenge than it is a
11 benefit from an audit perspective if we say the
12 number of employees can be the one and only
13 determining factor.
14 I get it being a judgmental issue. But let
15 me just ask the question: Is there a specific
16 company that you can think of that has had this
17 challenge in the past?
18 MS. TWOMEY: We don't have a specific
19 example of a company that we know of that the
20 example would be, once again, where if, you know,
21 the capital investment is not included as a test
22 measurement.
23 So, if you have an R & D company that's
24 first starting out and it only has six months of
25 operation in a fiscal year, they're not going to
26 have the capital investment test because it's being
27 excluded. They're not going to have, you know, more
28 than 50 percent in their year on operating expenses

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 because a lot of their expenses in the first year
2 will be capital investment, not so much operating
3 expenses.
4 They're not going to have a ton of, you
5 know, salaries and wages because they're -- relative
6 to the salaries and wages that people to put in the
7 equipment versus those that are actually conducting
8 the R & D, they're not as highly paid, they've only
9 had six months worth of that fiscal year, they would
10 be then disqualified if you don't take a look at the
11 number of employees.
12 There may be, you know, 100 or 200
13 employees engaged in R & D and -- but higher paid
14 personnel and higher paid investment to get that
15 place up and running.
16 So, if you exclude it altogether, they
17 would be disqualified under the regulations, but
18 they would be qualified under the statute because
19 that's what they do.
20 MS. STEEL: So, Ms. --
21 MR. HORTON: Madam Chair, I'd like to just
22 have staff sort of respond to their thoughts on
23 that.
24 I mean, I just can't think of a -- I mean,
25 I appreciate the hypothetical, but it seems to be
26 counterintuitive to me.
27 MR. MENDEL: I mean, when we looked at it
28 and we looked at -- the company gets to define

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 itself on a cost center basis.
2 MR. HORTON: Right.
3 MR. MENDEL: And we looked at -- the four
4 tests we have right now, we -- we couldn't come up
5 with a hypothetical that wouldn't qualify under one
6 of those tests if the cost center was legitimately
7 primarily engaged in a qualifying activity that --
8 unless you're hypothesizing some company where one
9 person makes more than all of these other people
10 combined and --
11 MR. HORTON: You can --
12 MR. MENDEL: -- the wages and salaries --
13 MR. HORTON: -- establish cost centers.
14 So --
15 MR. MENDEL: -- they don't seem to have any
16 expenses that are related to the research and
17 development -- we couldn't come up with a
18 hypothetical that seemed to exclude anybody that
19 should be included.
20 MS. MANDEL: So -- so, even the full-time
21 equivalent employees would be sort of cost center
22 'cause they'd have to be identified to that --
23 MR. HORTON: Cost center.
24 MS. MANDEL: -- cost center, right?
25 So, if they think there might be one and
26 you don't think there could be one, is there -- but
27 if there was one, they shouldn't be excluded?
28 MR. RUNNER: Right.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. MANDEL: Then is there any harm in
2 putting it in the --
3 MR. RUNNER: Precisely.
4 MR. MENDEL: Our only concern was it seemed
5 to be, more than any of the others, just something
6 that could be rather easily manipulated to give a
7 false positive.
8 MS. MANDEL: But -- well, and I think
9 that's -- that was part of why I asked about
10 full-time equivalents.
11 'Cause when I first saw it and it said
12 "number of employees," I'm like, well, yeah, you
13 could hire a different guy for every day of the week
14 and then juice up your numbers.
15 But if it's full-time equivalents, I
16 don't -- I mean, their language "number of
17 employees" wouldn't be the exact language because
18 that's not -- that doesn't -- that's expansive and
19 isn't restrictive to full-time.
20 MR. MENDEL: I think we agree that if it
21 said, "Number of employees based on full-time
22 equivalency," the chances of it being misused are --
23 go down significantly.
24 MR. RUNNER: That's the request, isn't it?
25 MS. TWOMEY: Yes. We had originally come
26 in with number of employees and number of employee
27 hours to compensate for that.
28 But, you know, we have now narrowed it down

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 to number of employees with the F. T. E. equivalent.
2 And, you know, one other thing I just want
3 to --
4 MS. MANDEL: Okay. So -- okay, that's --
5 MR. RUNNER: Just -- just again, my -- real
6 quick, my clarification.
7 MS. STEEL: Yeah.
8 MR. RUNNER: I mean, again what we're
9 talking about was a little -- in terms of some --
10 some discussion that was going on earlier and that
11 is it sounded like the understanding was you were
12 trying to narrow.
13 You're not trying to narrow, you're trying
14 expand, you're trying to add another alternative
15 measure, correct?
16 MS. TWOMEY: Yes. And it's -- the statute
17 clearly says you have to be engaged in the
18 manufacturing and R & D and the equipment has to be
19 used for manufacturing for R & D.
20 So, there's not a lot of abuse that can
21 happen there.
22 MR. RUNNER: Right.
23 MS. TWOMEY: You have to be in the specific
24 NAICS codes. You have to use that equipment for
25 manufacturing, R & D.
26 What we're simply asking is there are so
27 many industries that are included in the various
28 NAICS codes --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. RUNNER: Yeah.
2 MS. TWOMEY: -- and --
3 MR. RUNNER: And yet again, I appreciate
4 that and I think I understand where you're going.
5 Again, I can appreciate as a tax agency
6 we're trying to come up with these hypotheticals as
7 to who could qualify.
8 But I guess my tendency is to lie -- to
9 rely on the industry to know their industries who
10 could qualify more than we would as a tax agency,
11 'cause I'm not sure we probably have a comprehension
12 of how different people may work out there, what
13 their models are and whatnot.
14 But I would expect that the industry does
15 have a better idea as to how things might be
16 included, counted and accounted for.
17 MS. TWOMEY: Yes. And these are -- some of
18 the start ups that we are looking to attract, to
19 bring into the state that could be potentially
20 negatively affected and, therefore, disqualified
21 under the regs, but would qualify under the statute
22 if we excluded number of employees.
23 MS. STEEL: So, motion's on the floor as
24 the staff recommendation.
25 Substitute motion here?
26 MR. RUNNER: I would make a substitute
27 motion to include the number of employees.
28 MS. STEEL: Full-time?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. RUNNER: -- with -- based upon a
2 full-time equivalency.
3 MS. MANDEL: Second.
4 MR. HORTON: Just a quick comment.
5 I am as inclusive as I can possibly be as
6 it relates to this to include as many as folks we
7 possibly can.
8 But I still have the concern about the
9 interpretation causing challenge for those who don't
10 meet the 50 percent threshold in the -- the audit
11 process.
12 And certainly appreciate the advice of the
13 representatives of the industry, not to discount
14 that and would have liked to have had a specific
15 example, or even a historical example, where this
16 has been challenging for the State of California.
17 And I'm always concerned about the
18 unintended consequences of our actions as it relates
19 to what we see four years from now when a company
20 has been excluded at the audit level because they
21 didn't meet this criteria. And, ultimately, comes
22 before us and are faced with trying to communicate
23 that it wasn't the intent -- and particularly as the
24 Board changes, it wasn't the intent of the previous
25 Board to do that and this is the intent of the
26 current Board to interpret it that way.
27 Anyway, with that said, I would object to
28 that.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. STEEL: Okay. Substitute motion was
2 made by Member Runner and second by Member Randel --
3 Mandel. And then we have objection here.
4 Call the roll, please.
5 MS. RICHMOND: Mr. Horton?
6 MR. HORTON: No.
7 MS. RICHMOND: Ms. Steel?
8 MS. STEEL: Aye.
9 MS. RICHMOND: Mr. Runner?
10 MR. RUNNER: Aye.
11 MS. RICHMOND: Ms. Yee?
12 MS. YEE: No.
13 MS. RICHMOND: Ms. Mandel?
14 MS. MANDEL: Aye.
15 MS. RICHMOND: Motion carries.
16 MS. STEEL: Thank you. So, that's conclude
17 -- actually, we have another issue here.
18 So, first item's been done.
19 Ms. Buehler, and we have a second item.
20 MR. RUNNER: Oh, for the Committee, you are
21 right.
22 MS. STEEL: Yeah.
23 MS. BUEHLER: Okay, for the second agenda
24 item, we have you a lumber assessment update based
25 on the lumber returns filed by retailers for the
26 four quarters of 2013.
27 In the September 2013 Board meeting, this
28 Board approved emergency Regulations 2000 and 2001.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 The regulations allow for a reimbursement of $250
2 and an additional $485, respectively.
3 Staff have worked to refine the number of
4 lumber retailers identified in the main frame
5 system.
6 MR. RUNNER: Retailers who reported zero
7 lumber sales for a full year in 2013 have had their
8 lumber coding removed.
9 As a result, the number of locations
10 identified has been reduced to 5,695.
11 As shown in the update, the 2013 revenue
12 from the lumber assessment was $31.9 million.
13 Administrative costs for fiscal year '12-'13 were
14 $1.1 million.
15 With the 5,695 total accounts and
16 subaccounts eligible to claim reimbursement costs of
17 $735 per location, the total potential reimbursement
18 is $4.2 million. The total reimbursement actually
19 claimed by retailers today is approximately
20 $450,000. This leaves the remaining reimbursement
21 eligible to be claimed of $3.7 million.
22 Adjusting gross revenues for administrative
23 cross -- costs and reimbursement for retailers
24 leaves a net revenue of $26.6 million.
25 When the legislation was passed,
26 anticipated annual revenue for the program was
27 expected to be $30 million in net revenue to be
28 deposited in the Timber Regulation and Forest

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 Restoration Fund.
2 I would be happy to answer any questions
3 you may have.
4 MS. STEEL: Members, any comments or
5 questions?
6 MR. RUNNER: Quick question.
7 MS. STEEL: Member Runner.
8 MR. RUNNER: The whole purpose of these
9 ongoing discussions was to try to walk down this
10 path to see how it is that the real numbers worked
11 out with the available resources for the amount of
12 reimbursement.
13 MS. BUEHLER: Correct.
14 MR. RUNNER: And, so, it's pretty clear
15 right now that the numbers are bearing out that we
16 could, indeed, stay within some parameters that we
17 believe the legislature had given and be able to
18 then become a little more, how would you say, closer
19 to where it is that the industry has at least stated
20 that their reimbursements or their expenses are.
21 Is that a fair summary?
22 MS. BUEHLER: Given that we were expecting
23 $30 million and when you net out the costs, we're at
24 26.6 million, I'm not sure how close you want to
25 get.
26 MR. RUNNER: I'm talking about the
27 reimbursement portions of it, the amount of people
28 who were asking for reimbursement?

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. BUEHLER: Right.
2 MR. RUNNER: Right. Aren't those
3 numbers -- maybe I misunderstood there, the numbers
4 that we anticipated the cost of reimbursement was
5 for how much?
6 MS. STEEL: 32,000 people, I mean, the
7 businesses.
8 MR. RUNNER: Businesses -- I'm sorry.
9 MS. STEEL: 5,600?
10 MS. BUEHLER: Right, the number of business
11 locations --
12 MR. RUNNER: Right.
13 MS. BUEHLER: -- have been reduced from
14 approximately 25,000 --
15 MR. RUNNER: Right.
16 MR. BUEHLER: -- in September --
17 MR. RUNNER: But we had a number --
18 MS. BUEHLER: -- to 5695 now.
19 MR. RUNNER: -- I'm just looking not so
20 much at the numbers as much -- the numbers of
21 businesses as much as the amount of reimbursement.
22 MS. BUEHLER: The total reimbursement that
23 could be be claimed by these retailers in the
24 locations is 4.2 million.
25 To date they've only claimed the 450,000.
26 MR. RUNNER: That's the issue that I think
27 -- that's the key issue that I think we're -- that I
28 think is why we wanted these reports, to find out

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 where we were on that path.
2 MS. BUEHLER: Right. A number of retailers
3 did not take the additional reimbursement that was
4 authorized under Regulation 2001 at this point.
5 I think many may have been under the -- may
6 have made a conclusion that because it was effective
7 1-1 they can't reclaim it until their first quarter
8 return. Some did claim it with their fourth quarter
9 return.
10 MS. STEEL: So, what you are saying is they
11 going to come back?
12 MS. BUEHLER: They may still claim it on
13 their first quarter return, that additional amount.
14 MS. STEEL: How we reached out to those
15 businesses?
16 MR. RUNNER: Actually --
17 MS. STEEL: We do send out special notices
18 and e-mail blasts to all of the people who were
19 coded with the lumber accounts.
20 MS. STEEL: So, it might be more than
21 5,695?
22 MS. BUEHLER: No, we feel really confident
23 that --
24 MS. STEEL: Or just --
25 MS. BUEHLER: -- it'll be that locations or
26 even a lesser amount.
27 MR. RUNNER: I think we have somebody from
28 the industry here. Maybe he can give us an update

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 as to where they believe they are with the -- with
2 the number of reimbursements and whether -- what
3 they anticipate and what they're hearing from their
4 industry.
5 ---o0o---
6 KEN DUNHAM
7 ---o0o---
8 MR. DUNHAM: Good morning. And thank you
9 very much, Mr. Chairman and Committee Members.
10 I'm Ken Dunham. I'm the Executive Director
11 of the West Coast Lumber & Building Material
12 Association. We're the trade association for the
13 industry. Thank you.
14 We're getting closer to this. The numbers
15 that we talked about as far back as October of 2012
16 are beginning to come together.
17 The one question I had today when I saw the
18 figures for the first time yesterday was how many
19 filing locations generated the 31.9 million?
20 And I'm told -- was told informally that
21 that's about 2200 businesses that -- so, that --
22 that bears out that -- that probably you're going to
23 get, when this all sorts out, somewhere slightly
24 south of 3,000 business entities in the state.
25 If you look at the numbers that were
26 collected on this, 31.9 million collected from 2200
27 locations, that averages out to $14,500 per business
28 location. That is a tremendous amount of money from

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 relatively few businesses.
2 We've got some people that provided me some
3 internal information of how much they submitted.
4 And that's been in the -- in some cases, 40 to 50 to
5 $60,000 per business location.
6 So, we're -- we're hoping in the future
7 that you will come back closer to what the amount is
8 that we requested.
9 $5,500 is the average cost. It's also the
10 median cost. When you figured in the -- the large,
11 big box lumber yards in the state who are not our
12 members, their number came out to be very close to
13 that.
14 So, we -- these people are -- the lumber
15 dealers are facing the brunt of the -- of the public
16 wrath, at times, of having an additional 1 percent.
17 I know there was concern at one point that
18 people were not reporting accurately. Believe me,
19 they are. This is something that's being followed
20 very, very closely by the industry.
21 And we go back to the law that says --
22 simply says,
23 "Reimbursement shall be made to the
24 lumber dealers for their costs."
25 And thank you very, very much for just --
26 MR. RUNNER: Let me follow up on that --
27 MS. STEEL: Yes.
28 MR. RUNNER: -- with the individual.

1 Right now the total reimbursement -- we've
2 had two sets of -- we've had two approvals.
3 MR. DUNHAM: That's right.
4 MR. RUNNER: And, so, the total amount
5 right that is on the books that we've approved is --
6 MR. DUNHAM: 735.
7 MR. RUNNER: -- 735. Okay. So, my
8 question, I guess, would be back to the Department
9 and that is do we feel like we've got enough data
10 now that we could look at the path of increasing
11 that reimbursement?
12 Do we feel like we have a better handle on
13 the numbers of people who are going to be making the
14 claim, the total number of dollars that are being --
15 that are being used in that claim, to take a look at
16 that reimbursement?
17 MS. BUEHLER: We can certainly take a look
18 at anything.
19 My biggest concern is the 4.2 million that
20 hasn't been claimed at this point and what are the
21 reasons for them not claiming it -- whether they
22 don't have the expenses and they chose not to or
23 they are waiting for that first quarter return to do
24 whole amount or what are the causes there.
25 That would be my --
26 MR. RUNNER: And when would that date be?
27 MS. BUEHLER: First quarter return will be
28 due April 30th.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MR. RUNNER: So, by April 30th do you feel
2 like you would have a better idea?
3 MS. BUEHLER: We would have to have all the
4 returns processed.
5 MR. RUNNER: Okay.
6 MS. BUEHLER: So, it would be sometime
7 after --
8 MR. RUNNER: What would the date be?
9 MS. BUEHLER: -- that where we would have
10 an idea of who's claimed it with their first quarter
11 return.
12 But, again, I would still have the concern
13 for those who didn't do -- should we be reaching out
14 to them to find out is it an oversight or error on
15 their part for not doing that?
16 Or do we just assume that they -- they
17 reported accurately by putting zero in that
18 reimbursement amount?
19 And I would look to your guidance for that.
20 MR. RUNNER: Okay.
21 MS. STEEL: That's why some of us didn't
22 vote for $700 reimbursement here. And we knew that
23 that each business is going to be costing more than
24 $5500.
25 And then we assumed the number of
26 businesses that are asking for reimbursement was
27 over 32,000. And now know that it's about 5,600.
28 So --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. BUEHLER: Correct.
2 MS. STEEL: -- maybe we can -- something
3 that you can come back with, you know, other figures
4 that, you know, maybe we can just reimburse those
5 figures to the businesses.
6 Just really quick, we went through business
7 taxes such a long time, so --
8 MR. DUNHAM: Very quickly, I -- I think
9 your 5,695 number is still significantly high.
10 And I would only add too that this tax is
11 ongoing -- or this assessment.
12 2014 is going be a significantly better
13 business year for the lumber industry in the state
14 than it has been. But this is an ongoing
15 irritant --
16 MS. STEEL: Yeah, I understand.
17 MR. DUNHAM: -- in the industry.
18 MR. RUNNER: Well, for instance, I know --
19 like of the 5,000, I think it's 1,000 of them that
20 actually do $25,000 less -- or less a year in that
21 business.
22 MR. DUNHAM: At least.
23 MR. RUNNER: At least.
24 So, the -- how much claim they can have to
25 reimbursement ends up being pretty small because
26 they can only claim the amount of money that they
27 actually then owe, correct?
28 I mean, they can't --

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 MS. BUEHLER: They can claim up to the 735.
2 MR. RUNNER: Right, but only out of -- only
3 out of the money they actually collected?
4 MS. BUEHLER: I don't believe that's
5 accurate, sir.
6 MR. RUNNER: You mean they can go -- they
7 can claim beyond what is --
8 MS. BUEHLER: They're allowed to claim
9 what -- the reimbursement that was designated by the
10 Board and in this case we have --
11 MR. RUNNER: I thought -- I thought the
12 amount of the claim --
13 MS. BUEHLER: -- 735.
14 MR. RUNNER: -- had to come out of their --
15 their -- their lumber assessment reimbursement?
16 MS. BUEHLER: Are you meaning the 1 percent
17 that they're charging --
18 MR. RUNNER: Yes.
19 MS. BUEHLER: -- their customers?
20 MS. MANDEL: Yes.
21 MS. BUEHLER: Yes.
22 MR. RUNNER: There we go, there we go, yes,
23 yes.
24 So, what I'm saying is if you're only
25 collecting $25,000, it's going to take you a really
26 long time.
27 MS. MANDEL: Selling --
28 MR. RUNNER: You're only selling -- excuse

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 me, you're only selling 25 -- your claim --
2 MS. BUEHLER: Several years, yes.
3 MR. RUNNER: -- is going to take a long,
4 long time.
5 MS. BUEHLER: Yes.
6 MR. RUNNER: And like I said, I know more
7 than 20 percent of them fit that category.
8 MS. BUEHLER: Uh-huh.
9 MR. RUNNER: And, so, I -- I would hope
10 that we could ask the staff to come back with a more
11 -- with a good model based upon first -- first
12 quarter returns.
13 MS. BUEHLER: Okay.
14 MR. RUNNER: On what we could do to
15 readjust the -- the reimbursement.
16 I think that was the intent for us to have
17 this on the -- on the agenda again is to take a look
18 at the numbers.
19 We've got new numbers and we ought to
20 figure out what to do with them.
21 MS. STEEL: Thank you, Ms. Buehler.
22 MS. YEE: Madam Chair?
23 MS. STEEL: Yes, Member Yee.
24 MS. YEE: This reimbursement was a one time
25 reimbursement?
26 MS. BUEHLER: Yes.
27 MS. YEE: Okay. And do you believe our
28 administrative costs will be pretty much the same

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 going forward or will there be some decrease --
2 MS. BUEHLER: Uhmm --
3 MS. YEE: -- in this reimbursement issue?
4 MS. BUEHLER: If we don't change the
5 reimbursement amount, I would expect our -- our
6 administrative costs to go down slightly.
7 MS. YEE: Okay.
8 MS. BUEHLER: Because part of that is our
9 costs for the programming in the main frame system.
10 If we do another change, we will have to
11 again make changes in the main frame system. So, I
12 would expect they would stay the same.
13 MS. YEE: Okay. We were -- this Board was
14 put in a tenuous position of having to not only
15 interpret the legislative intent, but -- as related
16 to this reimbursement -- but also getting to this I
17 point in time of identifying, actually, the number
18 of retailers that we're dealing with.
19 But the overall goal, which I don't want to
20 have us lose sight of, is what the legislature
21 intended with this lumber assessment fee was to
22 generate revenue for this fund to tune of $30
23 million.
24 And, so, I think once we resolve this
25 reimbursement issue, it looks like we're close to
26 kind of getting to the $30 million.
27 What I would ask is that, Madam Chair, if
28 we could, as we're continuing to deliberate on the

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 level of reimbursement, I feel like we owe some
2 update to the legislature about what's happening
3 with this lumber assessment and what the current
4 thinking is.
5 'Cause I do think there is an assumption
6 that we're going to be helping to collect $30
7 million for the fund.
8 MS. STEEL: Okay. So, we going to come
9 back for newer number next -- Member Runner, next
10 three months?
11 MR. RUNNER: I -- I think --
12 MS. STEEL: The first quarter --
13 MR. RUNNER: -- I think staff will have to
14 help us understand what that target date is based
15 upon when you feel confident with those returns.
16 MS. STEEL: -- first quarter is when it's
17 going to be coming in and when you going to get the
18 numbers?
19 MS. BUEHLER: The first quarter returns are
20 due April 30th.
21 I don't think we'd be confident with
22 numbers until probably June.
23 MS. STEEL: So, would you like to come back
24 in June -- July?
25 MS. BUEHLER: July.
26 MS. STEEL: Okay, so, July come back.
27 And then as Member Yee requested, to
28 let legislators to know, you know, what numbers that

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 we collected and what numbers --
2 MS. BUEHLER: I will work with the Leg.
3 Division --
4 MS. STEEL: Yes.
5 MS. BUEHLER: -- to make sure that happens.
6 MS. STEEL: Thank you very much for all
7 that work. And thank you for coming out.
8 MR. DUNHAM: Thank you very much.
9 MR. RUNNER: Thanks.
10 MS. STEEL: And this --
11 MR. HORTON: Madam Chair?
12 MS. STEEL: -- yes?
13 MR. HORTON: This has been a laborious
14 process, I tell you.
15 I just want to -- I just wanted to thank
16 Mr. Runner and Member Yee for being on the front, as
17 well as our staff, reducing the numbers, clarifying,
18 solidifying and the openness and the flexibility
19 that has been, you know, portrayed by our -- by our
20 entire team to -- to -- to be considerate of the
21 little guys, if you will, and assure that they're
22 getting fully reimbursed.
23 I think a lot of our -- our retailers out
24 there who aren't reporting a whole lot -- you know,
25 let me leave that alone.
26 But I think -- I think there's a lot of
27 logic behind their actions.
28 MS. STEEL: Thank you.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 Thank you, Ms. Buehler.
2 MS. BUEHLER: Thank you.
3 MS. STEEL: And thank you very much. This
4 is -- this concludes Business Taxes Committee.
5 MS. MANDEL: Well, are we in recess?
6 MR. RUNNER: Recess?
7 MS. STEEL: Yeah, recess.
8 MS. BUEHLER: Okay.
9 ---o0o---
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2 MR. HORTON: Welcome back, Members and

3 guests. Let us reconvene the meeting of the Board

4 of Equalization, and thereby the meeting of the

5 Business Tax Committee wherein Member Steel is the

6 Chair.

7 MS. YEE: Ms. Mandel's still --

8 MR. HORTON: Oh.

9 MS. STEEL: We all got the language here.

10 Oh, where is Ms. Mandel?

11 MS. YEE: Here she comes.

12 MS. STEEL: Oh, okay. Yeah.

13 So we all read the language. Would you

14 read it --

15 MS. BUEHLER: Yes.

16 MS. STEEL: -- on the record?

17 MS. BUEHLER: I can certainly read it on

18 the record.

19 Staff did meet with industry and we've come

20 up with the language that we believe meets

21 everyone's needs at this point. For, in section

22 (b)(8) I'll start with the sentence that changed.

23 "...with respect to Codes 3111 to 3399,

24 a person will not be precluded from the

25 definition of a 'qualified person' when

26 there is no applicable six digit NAICS code

27 to describe their line of business,

28 provided that their business activities are

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 reasonably described in a qualified four
2 digit industry group.
3 "For example, a business in the
4 recycling industry may be regarded as a
5 'qualified person' when the activities of
6 the establishment are reasonably described
7 in a qualified four digit industry group."
8 MR. HORTON: Okay.
9 MS. STEEL: Any comment?
10 MS. YEE: No.
11 MS. STEEL: Is that okay?
12 MS. YEE: Great work by staff.
13 MS. STEEL: Motion?
14 MR. HORTON: Yes.
15 MS. STEEL: Thank you very much, Ms.
16 Buehler.
17 MR. HORTON: Second that motion.
18 MS. YEE: Yeah, move adoption and
19 authorization to publish.
20 MR. HORTON: Second.
21 MS. STEEL: Thank you. Member Yee moved
22 and Chairman Horton second.
23 And there's any objections?
24 Motion passed then.
25 Thank you very much.
26 MS. BUEHLER: Thank you.
27 MS. STEEL: This concludes Business Tax
28 Committee.

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 ---oOo---

2 REPORTER'S CERTIFICATE

3

4 State of California)

5) ss

6 County of Sacramento)

7

8 I, KATHLEEN SKIDGEL, Hearing Reporter for

9 the California State Board of Equalization certify

10 that on April 22, 2014 I recorded verbatim, in

11 shorthand, to the best of my ability, the

12 proceedings in the above-entitled hearing; that I

13 transcribed the shorthand writing into typewriting;

14 and that the preceding pages 1 through 43 and 101

15 through 103 constitute a complete and accurate

16 transcription of the shorthand writing.

17

18 Dated: May 7, 2014

19

20

21 Kathleen Skidgel

22 KATHLEEN SKIDGEL, CSR #9039

23 Hearing Reporter

24

25

26

27

28

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, JULI PRICE JACKSON, Hearing Reporter for

8 the California State Board of Equalization certify

9 that on April 22, 2014 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 44 through 100

14 constitute a complete and accurate transcription of

15 the shorthand writing.

16

17 Dated: May 12, 2014

18

19

20

21 JULI PRICE JACKSON

22 Hearing Reporter

23

24

25

26

27

28

Electronically signed by Juli Jackson (001-065-206-4972)
Electronically signed by Kathleen Skidgel (601-100-826-6264)
41756379-562b-42c1-b7e7-981f1501bd65

ESTIMATE OF COST OR SAVINGS RESULTING FROM PROPOSED REGULATORY ACTION

Proposed Amendment of Sales and Use Tax Regulation 1525.4, *Manufacturing and Research & Development Equipment*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement Prepared by _____ Date 6-9-14
Richard Bennion, Regulations Coordinator

Approved by _____ Date 6/11/14
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: **SAM Section 6615 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.**

Board Proceedings Division
01/22/14

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT (REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2013)

Instructions and Code Citations: SAM Section 6601-6616

ECONOMIC IMPACT STATEMENT

RTMENT NAME	CONTACT PERSON	EMAIL ADDRESS	TELEPHONE NUMBER
State Board of Equalization	Richard E. Bennion	rbennion@boe.ca.gov	916-445-2130

DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400	NOTICE FILE NUMBER
Title 18, Section 1525.4, Manufacturing and Research & Development Equipment	Z

A. ESTIMATED PRIVATE SECTOR COST IMPACTS *Include calculations and assumptions in the rulemaking record.*

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts business and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance
- ☐ g. Impacts individuals
- ☒ h. None of the above (Explain below):

Please see the attached .

If any box in Items 1 a through g is checked, complete this Economic Impact Statement.
If box in Item 1.h. is checked, complete the Fiscal Impact Statement as appropriate.

2. The _____ (Agency/Department) estimates that the economic impact of this regulation (which includes the fiscal impact) is:

- ☐ Below $10 million
- ☐ Between $10 and $25 million
- ☐ Between $25 and $50 million
- ☐ Over $50 million *[If the economic impact is over $50 million, agencies are required to submit a Standardized Regulatory Impact Assessment as specified in Government Code Section 11346.3(c)]*

3. Enter the total number of businesses impacted: _____

Describe the types of businesses (Include nonprofits): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

4. Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

5. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas): _____

6. Enter the number of jobs created: _____ and eliminated: _____

Describe the types of jobs or occupations impacted: _____

7. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here? ☐ YES ☐ NO

If YES, explain briefly: _____

Instructions and Code Citations:
SAM Section 6601-6616

ECONOMIC IMPACT STATEMENT (CONTINUED)

STIMATED COSTS *Include calculations and assumptions in the rulemaking record.*

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $ _____

   a. Initial costs for a small business: $ _____ Annual ongoing costs: $ _____ Years: _____

   b. Initial costs for a typical business: $ _____ Annual ongoing costs: $ _____ Years: _____

   c. Initial costs for an individual: $ _____ Annual ongoing costs: $ _____ Years: _____

   d. Describe other economic costs that may occur: _____

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. *Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.* $ _____

4. Will this regulation directly impact housing costs? ☐ YES ☐ NO

   If YES, enter the annual dollar cost per housing unit: $ _____

   Number of units: _____

5. Are there comparable Federal regulations? ☐ YES ☐ NO

   :plain the need for State regulation given the existence or absence of Federal regulations: _____

   Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $ _____

C. ESTIMATED BENEFITS *Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. Briefly summarize the benefits of the regulation, which may include among others, the health and welfare of California residents, worker safety and the State's environment: _____

2. Are the benefits the result of: ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

   Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $ _____

4. Briefly describe any expansion of businesses currently doing business within the State of California that would result from this regulation: _____

D. ALTERNATIVES TO THE REGULATION *Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

Instructions and Code Citations:
SAM Section 6601-6616

ECONOMIC IMPACT STATEMENT (CONTINUED)

ımmarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation: Benefit: $ _____ Cost: $ _____

Alternative 1: Benefit: $ _____ Cost: $ _____

Alternative 2: Benefit: $ _____ Cost: $ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ YES ☐ NO

Explain: _____

E. MAJOR REGULATIONS *Include calculations and assumptions in the rulemaking record.*

California Environmental Protection Agency (Cal/EPA) boards, offices and departments are required to submit the following (per Health and Safety Code section 57005). Otherwise, skip to E4.

1. Will the estimated costs of this regulation to California business enterprises **exceed $10 million**? ☐ YES ☐ NO

If YES, complete E2. and E3
If NO, skip to E4

riefly describe each alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

(Attach additional pages for other alternatives)

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation: Total Cost $ _____ Cost-effectiveness ratio: $ _____

Alternative 1: Total Cost $ _____ Cost-effectiveness ratio: $ _____

Alternative 2: Total Cost $ _____ Cost-effectiveness ratio: $ _____

4. Will the regulation subject to OAL review have an estimated economic impact to business enterprises and individuals located in or doing business in California exceeding $50 million in any 12-month period between the date the major regulation is estimated to be filed with the Secretary of State through12 months after the major regulation is estimated to be fully implemented?

☐ YES ☐ NO

If YES, agencies are required to submit a Standardized Regulatory Impact Assessment (SRIA) as specified in Government Code Section 11346.3(c) and to include the SRIA in the Initial Statement of Reasons.

5. Briefly describe the following:

The increase or decrease of investment in the State: _____

The incentive for innovation in products, materials or processes: _____

The benefits of the regulations, including, but not limited to, benefits to the health, safety, and welfare of California residents, worker safety, and the state's environment and quality of life, among any other benefits identified by the agency: _____

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2013)

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT *Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

☐ 1. Additional expenditures in the current State Fiscal Year which are reimbursable by the State. (Approximate) (Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

$ _____

☐ a. Funding provided in _____

Budget Act of _____ or Chapter _____, Statutes of _____

☐ b. Funding will be requested in the Governor's Budget Act of _____

Fiscal Year: _____

☐ 2. Additional expenditures in the current State Fiscal Year which are NOT reimbursable by the State. (Approximate) (Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

$ _____

Check reason(s) this regulation is not reimbursable and provide the appropriate information:

☐ a. Implements the Federal mandate contained in _____

☐ b. Implements the court mandate set forth by the _____ Court.

Case of: _____ vs. _____

☐ c. Implements a mandate of the people of this State expressed in their approval of Proposition No. _____

Date of Election: _____

☐ d. Issued only in response to a specific request from affected local entity(s).

Local entity(s) affected: _____

_____

☐ e. Will be fully financed from the fees, revenue, etc. from: _____

Authorized by Section: _____ of the _____ Code;

☐ f. Provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each;

☐ g. Creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

☐ 3. Annual Savings. (approximate)

$ _____

☐ 4. No additional costs or savings. This regulation makes only technical, non-substantive or clarifying changes to current law regulations.

☒ 5. No fiscal impact exists. This regulation does not affect any local entity or program.

☐ 6. Other. Explain _____

_____

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2013)

FISCAL IMPACT STATEMENT (CONTINUED)

FISCAL EFFECT ON STATE GOVERNMENT *Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

☐ 1. Additional expenditures in the current State Fiscal Year. (Approximate)

$ _____

It is anticipated that State agencies will:

☐ a. Absorb these additional costs within their existing budgets and resources.

☐ b. Increase the currently authorized budget level for the _____ Fiscal Year

☐ 2. Savings in the current State Fiscal Year. (Approximate)

$ _____

☒ 3. No fiscal impact exists. This regulation does not affect any State agency or program.

☐ 4. Other. Explain _____

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

☐ 1. Additional expenditures in the current State Fiscal Year. (Approximate)

$ _____

☐ 2. Savings in the current State Fiscal Year. (Approximate)

$ _____

☒ 3. No fiscal impact exists. This regulation does not affect any federally funded State agency or program.

☐ 4. Other. Explain _____

FISCAL OFFICER SIGNATURE	DATE
Joe Fitz	May 20, 2014

The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6601-6616, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.

AGENCY SECRETARY	DATE
Randy Fo[illegible]	May 20,, 2014

nce approval and signature is required when SAM sections 6601-6616 require completion of Fiscal Impact Statement in the STD. 399.

DEPARTMENT OF FINANCE PROGRAM BUDGET MANAGER	DATE
Exempt under SAM section 6615	

Attachment to Economic and Fiscal Impact Statement (STD. 399 (Rev. 12/2013)) for the Proposed Adoption of California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

As explained in more detail in the initial statement of reasons, Revenue and Taxation Code (RTC) section 6377.1, as enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and as amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013), exempts from some of the taxes imposed under California's Sales and Use Tax Law (RTC, § 6001 et. seq.), on and after July 1, 2014, and before July 1, 2022, the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property: (1) purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of tangible personal property; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in (1) or (2) above; and (4) and qualified tangible personal property purchased for use by a contractor for specified purposes.

As explained in more detail in the initial statement of reasons, the partial exemption applies to exempt qualifying transactions from the state general fund sales and use taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent. And, the Board anticipates that RTC section 6377.1 will have some economic impact on business and state revenue.

As explained in the initial statement of reasons, RTC section 6377.1 requires the purchaser to furnish the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe. The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023.

As explained in more detail in the initial statement of reasons, the State Board of Equalization (Board) is proposing to adopt California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment*, to implement, interpret, and make specific the provisions of RTC section 6377.1, and prescribe the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute. Proposed Regulation 1525.4 defines and further defines terms in the statute, including "qualified person," further explains when the partial exemption does and does not apply, and provides sample partial exemption certificates that purchasers and construction contractors may use to claim the exemption. In addition, the Board intends to make the sample partial exemption certificates set forth in appendices A and B to Regulation 1525.4 available to the public on the Board's website.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

All of the provisions in proposed Regulation 1525.4 are fully consistent with current law, including, RTC section 6377.1, and there is nothing in proposed Regulation 1525.4 that would significantly change how individuals and businesses would generally behave in response to RTC section 6377.1 in the absence of the proposed regulatory action, as explained in more detail in the initial statement of reasons. Therefore, the Board estimates that the proposed regulation will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact RTC section 6377.1 will have on individuals and businesses. And, the Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed regulation will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars ($50,000,000) during any 12-month period.

Furthermore, the Board has determined that proposed Regulation 1525.4 does not impose any costs on any persons, including businesses, which are not already imposed by RTC section 6377.1, and the Board has determined that there is nothing in proposed Regulation 1525.4 that would impact revenue. Therefore, based upon the foregoing information and all of the information in the rulemaking file, the Board has determined that the adoption of proposed Regulation 1525.4:

- Will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states;
- Will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor affect the expansion of businesses currently doing business in the State of California;
- Will not have a significant effect on housing costs;

- Will result in no direct or indirect cost or savings to any state agency, and will result in no cost or savings in federal funding to the State of California;
- Will result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, and will result in no other non-discretionary cost or savings imposed on local agencies; and
- Will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

In addition, proposed Regulation 1525.4 will not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of the regulation to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of proposed Regulation 1525.4 will not have a significant adverse economic impact on business, including the ability of California businesses to compete with businesses in other states.

The adoption of proposed Regulation 1525.4 may affect small businesses.

STATE OF CALIFORNIA--OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2014-0520-01		

For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

MAY 20 '14 MAY 30 '14

Office of Administrative Law

NOTICE REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY: State Board of Equalization

AGENCY FILE NUMBER (If any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
Manufacturing & Research & Development Equip.	18	1525.4	May 30, 2014

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
[X] Notice re Proposed Regulatory Action [ ] Other	Rick Bennion	(916) 445-2130	(916) 324-3984

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	[ ] Approved as Submitted [ ] Approved as Modified [ ] Disapproved/ Withdrawn		

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

ECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT

AMEND

TITLE(S)

REPEAL

3. TYPE OF FILING

[ ] Regular Rulemaking (Gov. Code §11346)

[ ] Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)

[ ] Emergency (Gov. Code, §11346.1(b))

[ ] Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.

[ ] Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)

[ ] Emergency Readopt (Gov. Code, §11346.1(h))

[ ] File & Print

[ ] Other (Specify) _____

[ ] Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)

[ ] Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

[ ] Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))

[ ] Effective on filing with Secretary of State

[ ] §100 Changes Without Regulatory Effect

[ ] Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

[ ] Department of Finance (Form STD. 399) (SAM §6660)

[ ] Fair Political Practices Commission

[ ] State Fire Marshal

[ ] Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY

For use by Office of Administrative Law (OAL) only

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment*. Proposed Regulation 1525.4 implements, interprets, and makes specific the partial sales and use tax exemption for the sale and storage, use, or other consumption of equipment used primarily in manufacturing, and research and development, established by RTC section 6377.1, and prescribes the form of the partial exemption certificate that must be furnished to the retailer under the statute.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on July 17-18, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on July 17 or 18, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of proposed Regulation 1525.4.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6377.1

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW PURSUANT TO GOVERNMENT CODE SECTION 11346.5, SUBDIVISION (a)(3)

Summary of Existing Laws and Regulations

As a general matter, California's Sales and Use Tax Law (RTC, div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an

exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;
- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70,

effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:
> (i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.
> (ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. Regulation 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person"

to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Effect, Objectives, and Benefits of the Proposed Adoption of Regulation 1525.4

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or

"problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1.

"primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");

- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1, subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty

Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3). Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of

of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of

RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meet the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The Board has performed an evaluation of whether proposed Regulation 1525.4 is inconsistent or incompatible with existing state regulations and determined that the proposed regulation is not inconsistent or incompatible with existing state regulations. This is because proposed Regulation 1525.4 is the only state regulation that specifically implements, interprets, and makes specific the provisions of RTC section 6377.1, prescribes the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute, and explains when such a certificate is taken timely and in good faith. Proposed Regulation 1525.4 is consistent with Regulation 1521, which contains the general provisions applicable to transactions involving construction contracts, and Regulation 1660, which contains the general provisions applicable to lease transactions. And, the Board reviewed Regulations 1525.2 and 1532 in detail, and specifically made proposed Regulation 1525.4 consistent with Regulations 1525.2 and 1532 to the extent that those regulations contained provisions that were appropriate for implementing the new partial exemption and consistent with RTC section 6377.1. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulation 1525.4.

NO MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Board has determined that the adoption of proposed Regulation 1525.4 will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement pursuant to title 2, division 4, part 7 (commencing with section 17500) of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost or savings to any state agency and will result in no cost or savings in federal funding to the State of California. The Board has also determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under title 2, division 4, part 7 (commencing with section 17500) of the Government Code, and will result in no other non-discretionary cost or savings imposed on local agencies.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that adoption of proposed Regulation 1525.4 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

NO KNOWN COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of Regulation 1525.4 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of proposed Regulation 1525.4 will not have a significant effect on housing costs.

STATEMENT REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed regulation should be directed to Andrew Kwee, by telephone at (916) 323-3096, by e-mail at Andrew.Kwee@boe.ca.gov, or by mail at State Board of Equalization, Attn: Andrew Kwee, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on July 17, 2014, or as soon thereafter as the Board begins the public hearing regarding proposed Regulation 1525.4 during the July 17-18, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, or contentions contained in those written comments before the Board decides whether to adopt proposed Regulation 1525.4. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared a copy of the text of proposed Regulation 1525.4 illustrating its express terms; however, the proposed regulation is not illustrated in underline or italics format because California Code of Regulations, title 1, section 8, subdivision (b) provides

that "[u]nderline or italic is not required for the adoption of a new regulation or set of regulations if the final text otherwise clearly indicates that all of the final text submitted to OAL for filing is added to the California Code of Regulations." The Board has also prepared an initial statement of reasons for the adoption of the proposed regulation, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed regulation is based are available to the public upon request.

The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 1525.4 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

EFFECTIVE DATE

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the partial exemption from sales and use tax provided by RTC section 6377.1, which is effective on and after July 1, 2014, and, once the regulation is effective, its provisions will have a retroactive effect pursuant to RTC section 7051. Therefore, the Board has determined that there is good cause to request an early effective date for Regulation 1525.4 in order to ensure that the regulation is effective as soon possible after the partial exemption is effective, and the Board intends to request an early effective date for Regulation 1525.4, pursuant to Government Code section 11343.4, subdivision (b)(3).

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 1525.4, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change <Legal.Regulations@BOE.CA.GOV>
Sent: Friday, May 30, 2014 9:57 AM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 1525.4

The State Board of Equalization proposes to adopt Regulation 1525.4, *Manufacturing and Research & Development Equipment*. A public hearing regarding the adoption of the proposed regulation will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on July 17-18, 2014.

Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*, implements, interprets, and makes specific Revenue and Taxation Code section 6377.1's partial exemption for the sale and use of equipment used primarily in manufacturing, and research and development.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1525_4_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Andrew Kwee, Tax Counsel III, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Andrew.Kwee@boe.ca.gov , telephone (916) 323-3096, or FAX (916) 323-3087.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please DO NOT REPLY to this message, as it was sent from an "announcement list."

Subscription Information: To unsubscribe from this list please visit the page: http://www.boe.ca.gov/aprc/index.htm

Privacy Policy Information: Your information is collected in accordance with our Privacy Policy http://www.boe.ca.gov/info/privacyinfo.htm

Technical Problems: If you cannot view the link included in the body of this message, please contact the Board's webmaster at webmaster@boe.ca.gov<mailto:webmaster@boe.ca.gov>

Bennion, Richard

From: BOE-Board Meeting Material
Sent: Friday, May 30, 2014 8:59 AM
To: Alonzo, Mary Ann (Legal); Angeja, Jeff (Legal); Angeles, Joel; Appleby, Jaclyn; Armenta, Christopher; Baetge, Michelle; Bartolo, Lynn; Bennion, Richard; Benson, Bill; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boyle, Kevin; Bridges, Cynthia; Brown, Michele C; Chung, Sophia (Legal); Cruz, Giovan; Davis, Toya P.; Delgado, Maria; Dixon, Camille; Duran, David; Elliott, Claudia; Epolite, Anthony (Legal); Ferris, Randy (Legal); Ford, Ladeena L; Garcia, Laura; Gau, David; Gilman, Todd; Goehring, Teresa; Hale, Mike; Hamilton, Tabitha; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Jacobson, Andrew; Kinkle, Sherrie L; Kinst, Lynne; Kruckenberg, Kendra; Kuhl, James; Lambert, Gary; Lambert, Robert (Legal); Lee, Chris; Levine, David H. (Legal); LoFaso, Alan; Madrigal, Claudia; Mandel, Marcy Jo; Matsumoto, Sid; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Oakes, Clifford; Pielsticker, Michele; Ralston, Natasha; Richmond, Joann; Riley, Denise (Legal); Salazar, Ramon; Salgado-Ponce, Sylvia; Schultz, Glenna; Shah, Neil; Silva, Monica (Legal); Singh, Sam; Smith, Kevin (Legal); Smith, Rose; Stowers, Yvette; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Tucker, Robert (Legal); Vandrick, Tanya; Vasquez, Rosalyn; Vigil, Michael; Wallentine, Sean; Whitaker, Lynn; White, Sharon; Williams, Lee; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 1525.4

The State Board of Equalization proposes to adopt Regulation 1525.4, *Manufacturing and Research & Development Equipment*. A public hearing regarding the adoption of the proposed regulation will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on July 17-18, 2014.

Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*, implements, interprets, and makes specific Revenue and Taxation Code section 6377.1's partial exemption for the sale and use of equipment used primarily in manufacturing, and research and development.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1525_4_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Andrew Kwee, Tax Counsel III, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Andrew.Kwee@boe.ca.gov , telephone (916) 323-3096, or FAX (916) 323-3087.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion

Regulations Coordinator
Phone (916) 445-2130
Fax (916) 324-3984
Richard.Bennion@boe.ca.gov

CONTACT PERSON

An interested person may request a copy of the proposed amended regulation and the Initial Statement of Reasons. Questions about the proposed regulation and Initial Statement of Reasons can be directed to the SMGB's office. All supplemental information, upon which the regulation is based, is contained in the rulemaking file.

The rulemaking file is available for inspection at the SMGB Office at 801 K Street, Suite 2015, Sacramento, California, between 9:00 a.m. and 4:00 p.m., Monday through Friday except during state holidays. Copies of the proposed regulation and the Initial Statement of Reasons may be requested by writing to the above address, or viewed on the SMGB's Internet Web Site at: **http://www.conservation.ca.gov/smgb**.

Inquiries concerning the substance of the proposed amended regulation should be directed to:

Mr. Stephen M. Testa, Executive Officer
State Mining and Geology Board
801 K Street, Suite 2015
Sacramento, California 95814
Phone: (916) 322–1082
Fax: (916) 445–0738
Stephen.Testa@conservation.ca.gov

OR
Amy Scott, Executive Assistant
State Mining and Geology Board
801 K Street, Suite 2015
Sacramento, CA 95814
Phone: (916) 322–1082
Fax: (916) 445–0738
Amy.Scott@conservation.ca.gov

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment.* Proposed Regulation 1525.4 implements, interprets, and makes specific the partial sales and use tax exemption for the sale and storage, use, or other consumption of equipment used primarily in manufacturing, and research and development, established by RTC section 6377.1, and prescribes the form of the partial exemption certificate that must be furnished to the retailer under the statute.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on July 17–18, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on July 17 or 18, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of proposed Regulation 1525.4.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6377.1

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW PURSUANT TO GOVERNMENT CODE SECTION 11346.5, SUBDIVISION (a)(3)

Summary of Existing Laws and Regulations

As a general matter, California's Sales and Use Tax Law (RTC, div. 2, pt. 1, chs. 1–11 (§ 6001 et seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the

tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;
- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley–Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchases made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time." RTC section 6377.1, subdivision (b)(6) provides that:

(A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.

(B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:

(i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.

(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley–Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. Regulation 1660, *Leases of Tangible Personal Property — In General,* prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment.* For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment.* As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra–company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Effect, Objectives, and Benefits of the Proposed Adoption of Regulation 1525.4

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multi-

ple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special–purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four–digit NAICS industry group code (but not a six–digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six– or four–digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14–001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1.

Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3). Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174–2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or fran-

chise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1, subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1–6, and clarified when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to

the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one–year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors,* still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap applies to fixtures and materials sold or used in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14–001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14–001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full–time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four–digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and ad-

dressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meet the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The Board has performed an evaluation of whether proposed Regulation 1525.4 is inconsistent or incompatible with existing state regulations and determined that the proposed regulation is not inconsistent or incompatible with existing state regulations. This is because proposed Regulation 1525.4 is the only state regulation that specifically implements, interprets, and makes specific the provisions of RTC section 6377.1, prescribes the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute, and explains when such a certificate is taken timely and in good faith. Proposed Regulation 1525.4 is consistent with Regulation 1521, which contains the general provisions applicable to transactions involving construction contracts, and Regulation 1660, which contains the general provisions applicable to lease transactions. And, the Board reviewed Regulations 1525.2 and 1532 in detail, and specifically made proposed Regulation 1525.4 consistent with Regulations 1525.2 and 1532 to the extent that those regulations contained provisions that were appropriate for implementing the new partial exemption and consistent with RTC section 6377.1. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulation 1525.4.

NO MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Board has determined that the adoption of proposed Regulation 1525.4 will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement pursuant to title 2, division 4, part 7 (commencing with section 17500) of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost or savings to any state agency and will result in no cost or savings in federal funding to the State of California. The Board has also determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under title 2, division 4, part 7 (commencing with section 17500) of the Government Code, and will result in no other non–discretionary cost or savings imposed on local agencies.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that adoption of proposed Regulation 1525.4 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

NO KNOWN COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of Regulation 1525.4 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of proposed Regulation 1525.4 will not have a significant effect on housing costs.

STATEMENT REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed regulation should be directed to Andrew Kwee, by telephone at (916) 323–3096, by e–mail at Andrew.Kwee@boe.ca.gov, or by mail at State Board of Equalization, Attn: Andrew Kwee, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279–0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445–2130, by fax at (916) 324–3984 , by e–mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279–0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on July 17, 2014, or as soon thereafter as the Board begins the public hearing regarding proposed Regulation 1525.4 during the July 17–18, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, or contentions contained in those written comments before the Board decides whether to adopt proposed Regulation 1525.4. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared a copy of the text of proposed Regulation 1525.4 illustrating its express terms; however, the proposed regulation is not illustrated in underline or italics format because California Code of Regulations, title 1, section 8, subdivision (b) provides that "[u]nderline or italic is not required for the adoption of a new regulation or set of regulations if the final text otherwise clearly indicates that all of the final text submitted to OAL for filing is added to the California Code of Regulations." The Board has also prepared an initial statement of reasons for the adoption of the proposed regulation, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed regulation is based are available to the public upon request.

The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 1525.4 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original pro-

posed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

EFFECTIVE DATE

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the partial exemption from sales and use tax provided by RTC section 6377.1, which is effective on and after July 1, 2014, and, once the regulation is effective, its provisions will have a retroactive effect pursuant to RTC section 7051. Therefore, the Board has determined that there is good cause to request an early effective date for Regulation 1525.4 in order to ensure that the regulation is effective as soon possible after the partial exemption is effective, and the Board intends to request an early effective date for Regulation 1525.4, pursuant to Government Code section 11343.4, subdivision (b)(3).

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 1525.4, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov.*

TITLE 21. DEPARTMENT OF TRANSPORTATION/DIVISION OF RIGHT OF WAY AND LAND SURVEYS

The Department of Transportation (Caltrans) proposes to adopt the proposed regulations described below after considering all comments, objections, and recommendations regarding the proposed action.

PUBLIC HEARING

Caltrans will hold public hearings at the time and place listed below. The meeting facilities are wheelchair accessible. At the hearings, any person may present statements orally, or in writing relevant to the proposed action described in the Informative Digest.

July 15, 2014 6:00 p.m.–8:00 p.m.
California State University, Los Angeles
Golden Eagle Building
Golden Eagle Ballroom
5151 State University Drive
Los Angeles, CA 90032

July 17, 2014 6:00 p.m.–8:00 p.m.
Pasadena Convention Center
Conference Center, Lower Level, Rm. 107
300 East Green Street
Pasadena, CA 91101

WRITTEN COMMENT PERIOD

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to Caltrans. Comments may also be submitted by facsimile (fax) at (916) 654–6378. or by e-mail to Affordable_Sales_Program@dot.ca.gov. The written comment period closes at 5:00 p.m. on July 14, 2014. Caltrans will consider only comments received by that time.

Please submit comments to:

Brent L. Green
Chief, Division of Right of Way and Land Surveys
ATTN: Affordable Sales Program
California Department of Transportation
1120 N Street, MS 37
Sacramento, CA 95814

AUTHORITY AND REFERENCE

Sections 118 through 118.6 of the Streets and Highways Code authorizes Caltrans to dispose of real property no longer required for transportation uses. Caltrans is implementing, interpreting, and making specific Sections 54235 through 54238.7 of the Government Code which requires that certain properties owned by state agencies be disposed in a manner that will preserve, upgrade, and expand the supply of housing available to affected persons and families of low or moderate income.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Caltrans acquires real property necessary for state transportation purposes, and must, by law, attempt to dispose of properties no longer required for those pur-

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
916-445-2130 • FAX 916-324-3984
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

May 30, 2014

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment*. Proposed Regulation 1525.4 implements, interprets, and makes specific the partial sales and use tax exemption for the sale and storage, use, or other consumption of equipment used primarily in manufacturing, and research and development, established by RTC section 6377.1, and prescribes the form of the partial exemption certificate that must be furnished to the retailer under the statute.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on July 17-18, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on July 17 or 18, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of proposed Regulation 1525.4.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6377.1

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW PURSUANT TO GOVERNMENT CODE SECTION 11346.5, SUBDIVISION (a)(3)

Summary of Existing Laws and Regulations

As a general matter, California's Sales and Use Tax Law (RTC, div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;

- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:
> (i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.

(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. Regulation 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in

teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Effect, Objectives, and Benefits of the Proposed Adoption of Regulation 1525.4

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1. Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3).
Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code

section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1, subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified

when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap

applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an

alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meet the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The Board has performed an evaluation of whether proposed Regulation 1525.4 is inconsistent or incompatible with existing state regulations and determined that the proposed regulation is not inconsistent or incompatible with existing state regulations. This is because proposed Regulation 1525.4 is the only state regulation that specifically implements, interprets, and makes specific the provisions of RTC section 6377.1, prescribes the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute, and explains when such a certificate is taken timely and in good faith. Proposed Regulation 1525.4 is consistent with Regulation 1521,

which contains the general provisions applicable to transactions involving construction contracts, and Regulation 1660, which contains the general provisions applicable to lease transactions. And, the Board reviewed Regulations 1525.2 and 1532 in detail, and specifically made proposed Regulation 1525.4 consistent with Regulations 1525.2 and 1532 to the extent that those regulations contained provisions that were appropriate for implementing the new partial exemption and consistent with RTC section 6377.1. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulation 1525.4.

NO MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Board has determined that the adoption of proposed Regulation 1525.4 will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement pursuant to title 2, division 4, part 7 (commencing with section 17500) of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost or savings to any state agency and will result in no cost or savings in federal funding to the State of California. The Board has also determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under title 2, division 4, part 7 (commencing with section 17500) of the Government Code, and will result in no other non-discretionary cost or savings imposed on local agencies.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that adoption of proposed Regulation 1525.4 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

NO KNOWN COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact

assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of Regulation 1525.4 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of proposed Regulation 1525.4 will not have a significant effect on housing costs.

STATEMENT REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed regulation should be directed to Andrew Kwee, by telephone at (916) 323-3096, by e-mail at Andrew.Kwee@boe.ca.gov, or by mail at State Board of Equalization, Attn: Andrew Kwee, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on July 17, 2014, or as soon thereafter as the Board begins the public hearing regarding proposed Regulation 1525.4 during the July 17-18, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, or contentions contained in those written comments before the Board decides whether to adopt

proposed Regulation 1525.4. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared a copy of the text of proposed Regulation 1525.4 illustrating its express terms; however, the proposed regulation is not illustrated in underline or italics format because California Code of Regulations, title 1, section 8, subdivision (b) provides that "[u]nderline or italic is not required for the adoption of a new regulation or set of regulations if the final text otherwise clearly indicates that all of the final text submitted to OAL for filing is added to the California Code of Regulations." The Board has also prepared an initial statement of reasons for the adoption of the proposed regulation, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed regulation is based are available to the public upon request.

The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 1525.4 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

EFFECTIVE DATE

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the partial exemption from sales and use tax provided by RTC section 6377.1, which is effective on and after July 1, 2014, and, once the regulation is effective, its provisions will have a retroactive effect pursuant to RTC section 7051. Therefore, the Board has determined that there is good cause to request an early effective date for Regulation 1525.4 in order to ensure that the regulation is effective as soon possible after the partial exemption is effective, and the Board intends to request an early effective date for Regulation 1525.4, pursuant to Government Code section 11343.4, subdivision (b)(3).

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 1525.4, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the July 17, 2014 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Initial Statement of Reasons for
Proposed Adoption of California Code of Regulations,
Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

SPECIFIC PURPOSES, PROBLEMS INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFITS

Current Law

As a general matter, California's Sales and Use Tax Law (Rev. & Tax. Code (RTC), div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the State Board of Equalization (Board), and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;

- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:

(i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.
(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. California Code of Regulations, title 18, section (Regulation) 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the

circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Proposed Regulation

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that

the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed

regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1. Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3).

Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1,

subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry

Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";

- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The adoption of proposed Regulation 1525.4 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to proposed Regulation 1525.4.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-001, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its April 22, 2014, Business Taxes Committee meeting in deciding to propose the adoption of Regulation 1525.4, described above.

ALTERNATIVES CONSIDERED

The Board considered whether to propose to adopt Regulation 1525.4 as recommended by staff in Formal Issue Paper 14-001 during its April 22, 2014, Business Taxes Committee meeting. In addition, the Board considered two reasonable alternatives to proposed Regulation 1525.4, where Board staff and interested parties had different proposed language.

First, RTC section 6377.1, subdivision (b)(6)(A) provides that the term qualified person means a person that is primarily engaged in those lines of business described in NAICS codes 3111 to 3399, inclusive, 541711, or 541712. Board staff suggested that proposed Regulation 1525.4, subdivision (b)(8)(A), clarify that a person may be a qualified person even if there is no applicable six digit NAICS code to describe the person's line of business, provided that their business activities are described in a qualified four digit industry group, without providing any examples. Waste Management suggested alternative language that added an example further clarifying that "the recycling industry will not be precluded from the definition of a '[q]ualified person' for not having a specific four or six digit NAICS code, provided that their activities and/or products are described in a qualified [four] digit [NAICS] industry group." (See Exhibit 4 to Formal Issue Paper 14-001.) After considering the proposed example, the Board (1) revised staff's suggested language to clarify that the business activity must be "reasonably" described in a qualified four digit industry group; (2) included a revised example in subdivision (b)(8)(A) of the proposed regulation, which clarifies that "a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group"; and (3) excluded the reference to "products" from the example.

Second, as explained more fully above, the definition of "qualified person" in RTC section 6377.1, subdivision (b)(6)(A), uses the phrase "primarily engaged," and existing law does not specifically define what is meant by "primarily engaged" for purposes of RTC section 6377.1. Board staff suggested that proposed Regulation 1525.4, subdivision (b)(8)(A)(1), include alternative tests to ascertain if an establishment is primarily engaged in a qualifying line of business based on: (1) gross revenue; (2) operating expenses; (3) employee salaries and wages; or (4) value of production. CalTax suggested alternative language adding, in addition to the tests noted above; (5) number of employees; (6) employee hours; (7) number of units produced; or (8) capital investment. (See Exhibit 3 to Formal Issue Paper 14-001.) After considering whether staff's language excluded persons from the definition of "qualified person" that should qualify for the partial exemption, the Board added one additional test for primarily engaged based on "number of employees," but further clarified that the additional test is "based on full time equivalency."

Furthermore, the California Poultry Federation's suggested that Regulation 1525.4 clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B). In Formal Issue Paper 14-001, Board staff concluded that the provisions in RTC section 6377.1, subdivision (b)(6)(B) are specific and would not allow staff to apply the establishment concept as suggested by the California Poultry Federation. After considering the California Poultry Federation's suggestion during the April 22, 2014, Business Taxes Committee meeting, several Board Members recommended that the California Poultry Federation seek an amendment to RTC section 6377.1 that would fix the issue identified by staff, and the Board did not make any changes to staff's recommended language for Regulation 1525.4 in response to this suggestion.

During the Board's April 22, 2014, Business Taxes Committee meeting, the Board decided to propose to adopt Regulation 1525.4 as recommended by staff and with the two changes noted above because the Board determined that the adoption of the proposed regulation is reasonably necessary for all the reasons provided above. The Board did not reject any reasonable alternative to proposed Regulation 1525.4 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)(1)

AB 93, as amended by SB 90, added section 6377.1 to the RTC effective July 11, 2013. Section 1 of AB 93 specifies that it is the intent of the Legislature in adding RTC section 6377.1 to exempt manufacturing equipment from state sales and use taxes in order to make California more competitive in attracting new businesses to this state. And, the Board anticipates that RTC section 6377.1 will have some economic impact on business and state revenue.

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1, define and further define statutory terms, including "qualified person," explain when the partial exemption does and does not apply, prescribe the form of the partial exemption certificate that must be provided to the retailer pursuant to RTC section 6377.1, subdivision (c), and provide sample partial exemption certificates to be used for claiming the partial exemption,. In addition, the Board intends to make the sample partial exemption certificates set forth in Appendices A and B to proposed Regulation 1525.4 available to the public on the Board's website.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

All of the provisions in proposed Regulation 1525.4 are fully consistent with current law, including RTC section 6377.1, and there is nothing in proposed Regulation 1525.4 that would significantly change how individuals and businesses would generally behave in response to RTC section 6377.1 in the absence of the proposed regulatory action. Therefore, the Board estimates that the proposed regulation will not have a measurable

economic impact on individuals and business that is in addition to whatever economic impact RTC section 6377.1 will have on individuals and businesses. And, the Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed regulation will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars ($50,000,000) during any 12-month period.

In addition, the Board has determined that proposed Regulation 1525.4 does not impose any costs on any persons, including businesses, which are not already imposed by RTC section 6377.1, and the Board has determined that there is nothing in proposed Regulation 1525.4 that would impact revenue. Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, proposed Regulation 1525.4 will not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of the regulation to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of proposed Regulation 1525.4 will not have a significant adverse economic impact on business.

The adoption of proposed Regulation 1525.4 may affect small businesses.

Proposed Text of

California Code of Regulations, Title 18, Section 1525.4,

Manufacturing and Research & Development Equipment,

(A new regulation to be added to the California Code of Regulations)

1525.4. Manufacturing and Research & Development Equipment.

(a) Partial Exemption for Property Purchased for Use in Manufacturing and Research and Development. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a)(1) or (2).

(4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) Definitions. For the purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation.

(4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) "Primarily" means 50 percent or more of the time.

(6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form,

including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property.

(8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are reasonably described in a qualified four digit industry group. For example, a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group. For the purpose of this subdivision:

> 1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005.
>
> A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities.
>
> A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of any one of the following to or from a qualifying line of business: (1) employee salaries and wages, (2) value of production, or (3) number of employees based on a full-time equivalency.

For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a company derives 40% of its gross revenues from qualified manufacturing activities and 40% from non-qualified manufacturing activities; but, the remaining 20% of its gross revenues are derived from qualified research and development contracts, the company would qualify because overall, 60% of the gross revenues are from qualifying activities.

Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination.

There may be more than one qualifying establishment within a legal entity.

In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

2. For purposes of this subdivision, "establishment" includes multiple or single physical locations (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712.

(B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include:

1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101.

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

(9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following:

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the qualified person or another party.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or

reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(B) "Qualified tangible personal property" does not include any of the following:

1. Consumables with a useful life of less than one year.

2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction.

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation.

(c) Partial Exemption Certificate.

(1) In General. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person.

(2) Blanket Partial Exemption Certificate. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) Form of Partial Exemption Certificate. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (7)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) Retention and Availability of Partial Exemption Certificates. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

(5) Good Faith. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3).

(d) When the Partial Exemption Does Not Apply. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business.

(2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under

subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption.

(e) Purchaser's Liability for the Payment of Sales Tax. If a purchaser certifies in writing to the seller that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

(f) Leases. Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

(g) Construction Contractors. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

(1) Partial Exemption Certificates. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a

qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e).

(2) Construction Contractors as Qualified Persons. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the $200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use.

(3) $200,000,000 Limit. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) Claim for Refund. Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6377.1, Revenue and Taxation Code.

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible property purchased or leased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- converted for use in a manner not qualifying for the exemption; **or**
- used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

Description of qualified tangible property purchased[1]:

; this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1525.4

Title: *Manufacturing and Research & Development Equipment*

Preparation: Andrew Kwee
Legal Contact: Andrew Kwee

Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*, implements, interprets, and makes specific Revenue and Taxation Code section 6377.1's partial exemption for the sale and use of equipment used primarily in manufacturing, and research and development.

History of Proposed Regulation:

July 17-18, 2014	Public Hearing
May 30, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
May 20, 2014	Notice to OAL
April 22, 2014	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA

Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Taxes Regulation 1525.4, *Manufacturing and Research & Development Equipment*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on May 30, 2014, 48 days prior to the public hearing.

July 17, 2014

Richard Bennion
Regulations Coordinator
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

JULY 17, 2014

PUBLIC HEARING

ITEM F1

PROPOSED ADOPTION OF SALES AND USE TAX

REGULATION 1525.4, MANUFACTURING AND RESEARCH &

DEVELOPMENT EQUIPMENT

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

Electronically signed by Kathleen Skidgel (601-100-826-6264)

2841969a-431e-4f26-be05-cc6ecb86772e

1 P R E S E N T

2

3 For the Board of Equalization: Jerome E. Horton
Chairman

4

5 Betty T. Yee
Member

6

7 George Runner
Member

8

9 Marcy Jo Mandel
Appearing for John
10 Chiang, State Controller
(per Government Code
11 Section 7.9)

12

Joann Richmond
13 Chief
Board Proceedings
14 Division

15 For Board of Equalization Staff: Andrew Kwee
16 Tax Counsel
Legal Department

17

Bradley Heller
18 Tax Counsel IV
Legal Department

19

Speaker: Therese Twomey
20 Fiscal Policy Director
CalTax

21

22 ---oOo---

23

24

25

26

27

28

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 JULY 17, 2014
4 ---oOo---
5 MR. HORTON: Okay. We're back on agenda.
6 Ms. Richmond.
7 MS. RICHMOND: Our next item is F, Public
8 Hearing; F1 Proposed Adoption of Sales and Use Tax
9 Regulation 1525.4, Manufacturing and Research and
10 Development Equipment. And we do have a speaker
11 MR. KWEE: Good afternoon. Good afternoon,
12 Chairman Horton and Members of the Board. I'm
13 Andrew Kwee with the Board's Legal Department; and
14 with me today is Brad Heller, also with the Legal
15 Department.
16 We're here to request that the Board vote
17 to adopt proposed Regulation 1525.4. The proposed
18 regulation interprets, implements, and makes
19 specific the partial sales and use tax exemption on
20 the sale and purchase for use in this state of
21 machinery and equipment used primarily in
22 manufacturing and research and development
23 activities.
24 We have not received any written public
25 comments on this matter.
26 Thank you.
27 MR. HORTON: Thank you very much. We'll
28 now, also on behalf of the Board, thank you for

1 your -- the laborious work that you've gone through
2 in getting us to this point. We certainly
3 appreciate that. We appreciate all the taxpayers
4 who have participated. And we see that we have
5 Therese here -- Ms. Tran here to -- to testify,
6 please.
7 ---oOo---
8 THERESE TWOMEY
9 ---oOo---
10 MS. TWOMEY: Thank you for using my maiden
11 name; it's been a long time.
12 I've waited all day just to say thank you
13 for your leadership on this issue; and also thank
14 you to your staff, as well as the Board's staff, on
15 this very important issue and to interpret the
16 regulations consistent with the economic growth that
17 was envisioned by the legislature. And just to say
18 let's get this economic engine moving.
19 Thank you.
20 MR. HORTON: Thank you.
21 Member Yee moves adoption on the
22 regulation. Second by Member Runner.
23 Without objection, Members, such will be
24 the order.
25 ---oOo---
26
27
28

1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, KATHLEEN SKIDGEL, Hearing Reporter for

8 the California State Board of Equalization certify

9 that on July 17, 2014 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 1 through 4 constitute

14 a complete and accurate transcription of the

15 shorthand writing.

16

17 Dated: July 24, 2014

18

19

20 Kathleen Skidgel

21 KATHLEEN SKIDGEL, CSR #9039

22 Hearing Reporter

23

24

25

26

27

28

Electronically signed by Kathleen Skidgel (601-100-826-6264) 2841969a-431e-4f26-be05-cc6ecb86772e

The Board deferred consideration of the matter to the August 2014, Culver City Board meeting.

PUBLIC HEARINGS

F1 Proposed Adoption of Sales and Use Tax Regulation 1525.4, *Manufacturing and Research & Development Equipment*

Andrew Kwee, Tax Counsel, Legal Department, made introductory remarks regarding Regulation 1524.4, which implements Revenue and Taxation Code section 6377.1's partial exemption for the sale and use of equipment used primarily in manufacturing and research and development (Exhibit 7.3).

Speaker: Therese Twomey, Fiscal Policy Director, California Taxpayers Association

Action: Upon motion of Ms. Yee, seconded by Mr. Runner and unanimously carried, Mr. Horton, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, Ms. Steel absent, the Board adopted Regulation 1525.4 as published.

[G1] LEGAL APPEALS MATTERS, CONSENT

The Board deferred consideration of the following matter: *G1.11 Kiwi Stair, Inc., 602125.*

With respect to the Legal Appeals Matters Consent Agenda, upon a single motion of Ms. Mandel, seconded by Ms. Yee and unanimously carried, Mr. Horton, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, Ms. Steel absent, the Board made the following orders:

G1.1 Ronald Avedisian, 434518 (AC)
04/01/04 to 02/13/07, $2,805,008.60 Tax
Action: Redetermine as recommended by the Appeals Division.

G1.2 Behmard & Associate, Inc., 588418 (AP)
07/01/06 to 09/30/09, $1,439,314.17 Tax, $143,931.47 Negligence Penalty
Action: Redetermine as recommended by the Appeals Division.

G1.3 Capital Cookery, Inc., 536609 (KH)
01/01/06 to 06/30/09, $189,700.56 Tax, $18,970.09 Negligence Penalty
Action: Redetermine as recommended by the Appeals Division.

G1.4 Partnership of Bridget Riley Hicks and Fred Hicks, 558251 (UT)
11/01/07, $3,625.00 Tax
Action: Redetermine as recommended by the Appeals Division.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
916-445-2130 • FAX 916-324-3984
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

May 30, 2014

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1525.4, *Manufacturing and Research & Development Equipment*. Proposed Regulation 1525.4 implements, interprets, and makes specific the partial sales and use tax exemption for the sale and storage, use, or other consumption of equipment used primarily in manufacturing, and research and development, established by RTC section 6377.1, and prescribes the form of the partial exemption certificate that must be furnished to the retailer under the statute.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on July 17-18, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on July 17 or 18, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of proposed Regulation 1525.4.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6377.1

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW PURSUANT TO GOVERNMENT CODE SECTION 11346.5, SUBDIVISION (a)(3)

Summary of Existing Laws and Regulations

As a general matter, California's Sales and Use Tax Law (RTC, div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;

- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:
> (i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.

(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. Regulation 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in

teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Effect, Objectives, and Benefits of the Proposed Adoption of Regulation 1525.4

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1. Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3).
Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code

section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1, subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified

when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap

applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an

alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meet the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The Board has performed an evaluation of whether proposed Regulation 1525.4 is inconsistent or incompatible with existing state regulations and determined that the proposed regulation is not inconsistent or incompatible with existing state regulations. This is because proposed Regulation 1525.4 is the only state regulation that specifically implements, interprets, and makes specific the provisions of RTC section 6377.1, prescribes the form of the partial exemption certificate that the purchaser must furnish to the retailer under the statute, and explains when such a certificate is taken timely and in good faith. Proposed Regulation 1525.4 is consistent with Regulation 1521,

which contains the general provisions applicable to transactions involving construction contracts, and Regulation 1660, which contains the general provisions applicable to lease transactions. And, the Board reviewed Regulations 1525.2 and 1532 in detail, and specifically made proposed Regulation 1525.4 consistent with Regulations 1525.2 and 1532 to the extent that those regulations contained provisions that were appropriate for implementing the new partial exemption and consistent with RTC section 6377.1. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulation 1525.4.

NO MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Board has determined that the adoption of proposed Regulation 1525.4 will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement pursuant to title 2, division 4, part 7 (commencing with section 17500) of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost or savings to any state agency and will result in no cost or savings in federal funding to the State of California. The Board has also determined that the adoption of proposed Regulation 1525.4 will result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under title 2, division 4, part 7 (commencing with section 17500) of the Government Code, and will result in no other non-discretionary cost or savings imposed on local agencies.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that adoption of proposed Regulation 1525.4 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

NO KNOWN COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact

assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of Regulation 1525.4 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of proposed Regulation 1525.4 will not have a significant effect on housing costs.

STATEMENT REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed regulation should be directed to Andrew Kwee, by telephone at (916) 323-3096, by e-mail at Andrew.Kwee@boe.ca.gov, or by mail at State Board of Equalization, Attn: Andrew Kwee, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on July 17, 2014, or as soon thereafter as the Board begins the public hearing regarding proposed Regulation 1525.4 during the July 17-18, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, or contentions contained in those written comments before the Board decides whether to adopt

proposed Regulation 1525.4. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared a copy of the text of proposed Regulation 1525.4 illustrating its express terms; however, the proposed regulation is not illustrated in underline or italics format because California Code of Regulations, title 1, section 8, subdivision (b) provides that "[u]nderline or italic is not required for the adoption of a new regulation or set of regulations if the final text otherwise clearly indicates that all of the final text submitted to OAL for filing is added to the California Code of Regulations." The Board has also prepared an initial statement of reasons for the adoption of the proposed regulation, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed regulation is based are available to the public upon request.

The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 1525.4 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

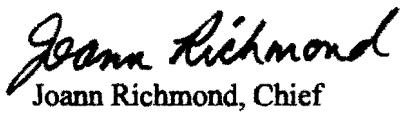
EFFECTIVE DATE

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the partial exemption from sales and use tax provided by RTC section 6377.1, which is effective on and after July 1, 2014, and, once the regulation is effective, its provisions will have a retroactive effect pursuant to RTC section 7051. Therefore, the Board has determined that there is good cause to request an early effective date for Regulation 1525.4 in order to ensure that the regulation is effective as soon possible after the partial exemption is effective, and the Board intends to request an early effective date for Regulation 1525.4, pursuant to Government Code section 11343.4, subdivision (b)(3).

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 1525.4, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:reb

Initial Statement of Reasons for Proposed Adoption of California Code of Regulations, Title 18, Section 1525.4, *Manufacturing and Research & Development Equipment*

SPECIFIC PURPOSES, PROBLEMS INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFITS

Current Law

As a general matter, California's Sales and Use Tax Law (Rev. & Tax. Code (RTC), div. 2, pt. 1, chs. 1-11 (§ 6001 et. seq.)) imposes sales tax on retailers, and the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California, unless an exemption or exclusion applies. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the State Board of Equalization (Board), and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6202, 6203; Cal. Code Regs., tit. 18, §§ 1684, 1686.)

The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See RTC, §§ 6011, 6012.) The current statewide sales and use tax rate is 7.50 percent, although the combined tax rate is higher in cities and counties that impose additional district transactions (sales) and use taxes in conformity with the Transactions and Use Tax Law (RTC, § 7251 et seq.). The 7.50 percent rate is comprised of:

- The .50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Public Safety Fund by section 35 of article XIII of the California Constitution;
- The .25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Education Protection Account by section 36 of article XIII of the California Constitution;

- The 3.6875 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are deposited in the state's general fund;
- The 0.50 percent rate of the sales and use taxes imposed and required to be deposited in the state's Local Revenue Fund by RTC sections 6051.2 and 6201.2;
- The 0.25 percent rate of the sales and use taxes imposed by RTC sections 6051.3 and 6201.3 that are deposited in the state's general fund;
- The 0.25 percent rate of the sales and use taxes imposed and required to be deposited in the state's Fiscal Recovery Fund by RTC sections 6051.5 and 6201.5;
- The 1.0625 percent rate of the sales and use taxes imposed by RTC sections 6051 and 6201 that are required to be deposited in the state's Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15; and
- The 1.00 percent rate specified by RTC section 7203.1 for local sales and use taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC, § 7200 et seq.).

RTC section 6377.1 was enacted by Assembly Bill No. (AB) 93 (Stats. 2013, ch. 69, effective July 11, 2013), and amended by Senate Bill No. (SB) 90 (Stats. 2013, ch. 70, effective July 11, 2013). RTC section 6377.1, subdivision (a), provides a partial exemption from sales and use tax on certain sales and purchase made on and after July 1, 2014, and before July 1, 2022. The partial exemption applies to: (1) qualified tangible personal property purchased by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, including packaging if required; (2) qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development; (3) qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described under (1) or (2) above; and (4) qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for a qualified person that will use that property for statutorily specified purposes.

RTC section 6377.1, subdivision (b), defines relevant terms used in subdivision (a), including "fabricating," "manufacturing," "primarily," "process," "processing," "qualified person," "qualified tangible personal property," "refining," "research and development," and "useful life." As relevant here, RTC section 6377.1, subdivision (b)(3), provides that "'Primarily' means 50 percent or more of the time. RTC section 6377.1, subdivision (b)(6) provides that:

> (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.
> (B) Notwithstanding subparagraph (A), "qualified person" shall not include either of the following:

(i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.
(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

And, RTC section 6377.1, subdivision (b)(7)(A)(iv) provides that qualified tangible personal property includes "Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included."

RTC section 6377.1, subdivision (c), provides that the partial exemption shall not be allowed, unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the Board may prescribe, and the retailer retains the exemption certificate in its records and furnishes it to the Board upon request.

RTC section 6377.1, subdivision (d), specifies that the partial exemption does not apply to any local sales and use taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or district transactions and use taxes levied pursuant to the Transactions and Use Tax Law. Subdivision (d) also specifies that the partial exemption does not apply to any sales and use taxes levied pursuant to RTC sections 6051.2, 6051.5, 6201.2, and 6201.5, any sales and use taxes levied pursuant to section 35 of article XIII of the California Constitution, and any sales and use taxes levied pursuant to RTC sections 6051 and 6201 that are required to be deposited in the Local Revenue Fund 2011 by RTC sections 6051.15 and 6201.15. Therefore, the partial exemption applies to the state general fund taxes imposed by RTC sections 6051, 6051.3, 6201, and 6201.3, and the state's Education Protection Account tax imposed by section 36 of article XIII of the California Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption rate is 4.1875 percent. After the state's Education Protection Account tax expires on December 31, 2016, the partial exemption rate will be 3.9375 percent.

RTC section 6377.1, subdivision (e)(1)(A), provides that the partial exemption shall not apply to "[a]ny tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section." It also provides that "in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year."

RTC section 6377.1, subdivision (f), provides that the partial exemption applies to leases which are classified as continuing sales and continuing purchases for purposes of the sales and use tax law. California Code of Regulations, title 18, section (Regulation) 1660, *Leases of Tangible Personal Property - In General*, prescribes the general application of sales and use tax to leases.

The partial exemption expires on July 1, 2022, in accordance with RTC section 6377.1, subdivision (a). And, RTC section 6377.1 is repealed by its own terms effective January 1, 2023, per RTC section 6377.1, subdivision (h).

RTC section 6377.1 is substantially, but not entirely, modeled after the partial sales and use tax exemption provided by RTC section 6377 (repealed by its own terms January 1, 2004) and interpreted in Regulation 1525.2, *Manufacturing Equipment*. For purchases made from January 1, 1994, through December 31, 2003, RTC section 6377 generally provided a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in the manufacturing, processing, refining, fabricating, or recycling of property, or research and development. In addition, RTC section 6377, subdivision (b)(3), provided that "'Primarily' means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a)." RTC section 6377, subdivision (b)(6)(B), required a "qualified person" to be "engaged in those lines business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual" 1987 edition, published by the OMB. And, RTC section 6377, subdivision (c), provided that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1525.2, subdivision (c)(6)(B), explained that:

- "For purposes of classifying a line or lines of business [under RTC section 6377, subdivision (b)(6)(B)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production"; and
- "Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting."

Regulation 1525.2 also prescribed the form of the exemption certificate required by RTC section 6377, provided a sample "section 6377" exemption certificate, and prescribed the

circumstances under which a seller may accept a "section 6377" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

To a lesser extent, RTC section 6377.1 was also modeled after provisions in RTC section 6378 and interpreted in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*. As relevant here, RTC section 6378 currently provides a partial exemption from sales and use tax for tangible personal property purchased for use by a qualified person to be used primarily in teleproduction and other postproduction services. In addition, RTC section 6378, subdivision (c)(1) provides that "primarily" means "tangible personal property used 50 percent or more of the time in" a qualified activity. RTC section 6378, subdivision (c)(2) provides that "qualified person" means "any person that is primarily engaged in teleproduction or other postproduction activities that are described in Code 512191 of the" NAICS, 1997 edition. And, RTC section 6378, subdivision (d), provides that "No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate."

Furthermore, as relevant here, Regulation 1532, subdivision (c)(2), explains that:

- "For purposes of classifying a line of business [under RTC section 6378, subdivision (c)(2)], the economic unit shall be the 'establishment' and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues";
- "'Primarily engaged' means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in 'teleproduction or other postproduction services' for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used"; and
- "In the case of a nonprofit teleproduction or other postproduction establishment, 'primarily engaged' means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

Regulation 1532 also prescribed the form of the exemption certificate required by RTC section 6378, provided two sample "section 6378" exemption certificates, including a blanket exemption certificate, and prescribed the circumstances under which a seller may accept a "section 6378" exemption certificate in good faith for purposes of being relieved of the obligation to pay or collect tax.

Proposed Regulation

There is currently no regulation that specifically implements, interprets, or makes specific the partial exemption from sales and use tax established by RTC section 6377.1. There is currently no regulation that prescribes the form of the partial exemption certificate that

the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, or provides a sample partial exemption certificate. Also, there is no regulation that specifically prescribes the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser.

In addition, there is currently no regulation that defines what is meant by the phrase "primarily engaged" in a qualifying line of business for purposes of RTC section 6377.1, subdivision (b)(6). There is currently no regulation that clarifies and explains the meaning of the phrase "special purpose buildings and foundations" as used in RTC section 6377.1, subdivision (b)(7)(A)(iv). There is currently no regulation that clarifies and explains how the partial exemption applies in the context of lease transactions. And, there is currently no regulation that clarifies how the partial exemption applies in the context of construction contracts.

Business Taxes Committee Process

Board staff determined that it was necessary to draft proposed Regulation 1525.4 to have the effect and accomplish the objectives of fully implementing, interpreting, and making specific the provisions of RTC section 6377.1 and specifically addressing the issues (or "problems" within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) identified above. Therefore, Board staff prepared a draft of the regulation and held its first meeting to discuss the draft with interested parties on October 9, 2013.

At the October 9, 2013, meeting, staff responded to written comments received prior to the meeting, as well as other suggestions to clarify the draft regulation, including expanding upon the definitions provided in RTC section 6377.1, clarifying the phrase "primarily engaged," clarifying how tax applies to testing equipment and manufacturing aids, allowing for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, providing a separate partial exemption certificate for construction contractors to use, and clarifying the application of the $200 million annual cap. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of proposed Regulation 1525.4 and, on November 14, 2013, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the October 9, 2013, meeting and to the interested parties that submitted written comments regarding the initial draft of the proposed regulation.

Board staff held a second meeting with interested parties on December 5, 2013, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, as well as other suggestions to clarify the definition of "qualified person," clarify when a purchaser is "primarily engaged" in a qualifying line of business, clarify how the partial exemption applies in the context of construction contracts, including contracts for special purpose buildings and foundations, and make various other minor revisions or edits. Then, staff incorporated the suggestions discussed at the meeting into a revised draft of the proposed

regulation and, on January 31, 2014, staff posted the revised draft of the proposed regulation on the Board's website, and distributed the revised draft of the proposed regulation to the interested parties that attended the December 5, 2013, meeting.

Board staff held a third meeting with interested parties on February 18, 2014, to discuss the revised draft of proposed Regulation 1525.4. At the meeting, staff responded to written comments received prior to the December 5, 2013, meeting, and agreed to address other suggestions to clarify how tax applies when a purchaser has a qualifying four digit NAICS industry group code (but not a six digit code); further clarify the phrase "primarily engaged"; and add additional tests to ascertain if a purchaser is primarily engaged in a qualifying activity. At the meeting, staff also received suggestions to provide that a qualified person may include an otherwise qualified "establishment" in an apportioning trade or business, subject to RTC section 6377.1, subdivision (b)(6)(B), and businesses that do not have a qualifying six or four digit NAICS code described in RTC section 6377.1, subdivision (b)(6)(A). However, staff did not agree to incorporate these suggestions into the proposed regulation because they are precluded by the express language of RTC section 6377.1.

Therefore, Board staff subsequently prepared Formal Issue Paper 14-001, which recommended that the Board adopt staff's revised draft of proposed Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1. Specifically, subdivision (a) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (a)(1) through (4), prescribing the types of transactions that qualify for the new partial exemption, identified the specific sales and use taxes the partial exemption provided by RTC section 6377.1 does and does not apply to, and provided notice of the partial exemption rates from July 1, 2014, to December 31, 2016, and January 1, 2017, to June 30, 2022.

Subdivision (b) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definitions of "fabricating," "primarily," and "processing" verbatim from RTC section 6377.1, subdivision (b)(1), (3), and (5). Subdivision (b) incorporated the statutory definition of "manufacturing" from RTC section 6377.1, subdivision (b)(2), and clarified when tangible personal property will be treated as having a greater service life or greater functionality for purposes of that definition, using language borrowed from Regulation 1525.2, subdivision (c)(10)(B), and Regulation 1525.2, subdivision (c)(2), respectively. Subdivision (b) defined "packaging" as used in RTC section 6377.1, subdivision (a)(1) and (b)(4) based, in part, on the definition of "packaging" in Regulation 1525.2, subdivision (a)(1)(B). Subdivision (b) defined "pollution control" as used in RTC section 6377.1, subdivision (b)(7)(A)(iii), and clarified that an activity is a pollution control activity to the extent it meets or *exceeds* pollution control standards established by the state or any local or regional governmental agency within the state consistent with RTC section 6377, subdivision (b)(11)(C) and Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) incorporated the statutory definition of "process" from RTC section 6377.1, subdivision (b)(6), and clarified that the term "process" includes the activity of testing products for quality assurance before they are altered to their completed form, as referred to in RTC section 6377.1, subdivision (a)(3).

Subdivision (b) defined "recycling" and "refining" as used in RTC section 6377.1, subdivisions (a)(1) and (4), and (b)(4). Subdivision (b) incorporated the definition of "research and development" from RTC section 6377.1, subdivision (b)(9), and clarified the definition by incorporating provisions from 26 Code of Federal Regulation part 1.174-2, subdivision (a), which defines the term "research and development" for purposes of Internal Revenue Code section 174. And, subdivision (b) implemented the definition of "useful life" provided by RTC section 6377.1, subdivision (b)(10), by explaining when property is and is not treated as having a useful life of one or more years for state income or franchise tax purposes using language borrowed from Regulation 1525.2, subdivision (c)(9)(B) and (10)(B).

Subdivision (b)(8) of the revised draft of proposed Regulation 1525.4 incorporated the definition of "qualified person" from RTC section 6377.1, subdivision (b)(6). Subdivision (b)(8) also:

- Provided a definition for the term "primarily engaged," as used in RTC section 6377.1, subdivision (b)(6);
- Clarified that "primarily engaged" is intended to have a similar meaning to "primarily engaged" as used in RTC section 6378, as interpreted by Regulation 1532, subdivision (c)(2) (the definition of "primarily" in RTC section 6377.1, subdivision (b)(3), is intended to have the same meaning as the definition of "primarily" in RTC section 6378, subdivision (c)(1) and therefore does not apply to "primarily engaged");
- Clarified that a qualified person may be primarily engaged in a qualifying activity or activities described in RTC section 6377.1, subdivision (a), either as a "legal entity" (meaning a "person" as defined in RTC, § 6005) or as an "establishment," similar to Regulation 1525.2, subdivision (c)(6)(B), and Regulation 1532, subdivision (c)(2);
- Defined the term "establishment" in a manner that is similar to Regulation 1525.2, subdivision (c)(6)(B);
- Generally incorporated the "gross revenue" test for determining when a qualified person is "primarily engaged" and the "funds allocated" test for determining when a nonprofit is "primarily engaged" from Regulation 1532, subdivision (c)(2), and, based upon input from interested parties, added "operating expense" tests for legal entities and establishments;
- Provided an alternative "value of production" test for determining when an establishment is "primarily engaged" that is similar to the "value of production" test in Regulation 1525.2, subdivision (c)(6)(B), and, based upon input from interested parties, also provided an alternative "employee salaries and wages" test for establishments;
- Clarified the reference to RTC section 25128 in RTC section 6377.1, subdivision (b)(6)(B), by generally describing the trades or businesses that are subject to the provisions of section 25128.

Subdivision (b)(9) of the revised draft of proposed Regulation 1525.4 incorporated the statutory definition of "qualified tangible personal property" from RTC section 6377.1,

subdivision (a)(7). Subdivision (b) clarified when manufacturing aids are considered "qualified tangible personal property," and clarified that qualified tangible personal property includes tangible personal property used in pollution control that *exceeds* pollution control standards established by this state or any local or regional governmental agency within this state consistent with Regulation 1525.2, subdivision (c)(10)(C). Subdivision (b) further defined and clarified the meaning of "special purpose buildings and foundations" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(A)(iv), using language borrowed from RTC section 6377, subdivision (b)(11)(D), and Regulation 1525.2, subdivision (c)(10)(D)1-6, and clarified when the partial exemption does and does not apply to transactions involving special purpose buildings and foundations. And, subdivision (b) provided that the "extraction processes" as used in the definition of qualified property in RTC section 6377.1, subdivision (a)(7)(B)(ii), includes such severance activities as mining, oil and gas extraction, as was also provided in Regulation 1525.2, subdivision (c)(9)(C).

Subdivision (c) of the revised draft of proposed Regulation 1525.4 prescribed the form of the partial exemption certificate that the purchaser is statutorily required to furnish to the retailer under RTC section 6377.1, allowed for the issuance of a blanket partial exemption certificate to cover multiple purchases from the same vendor, and prescribed the circumstances under which a retailer may accept such a partial exemption certificate in good faith for purposes of relieving the retailer of liability for the sales tax or the duty of collecting the use tax from the purchaser, similar to Regulation 1532, subdivision (e). Subdivision (c) also provides that qualified purchasers may use the sample partial exemption certificate set forth in appendix A, and construction contractors may use the sample partial exemption certificate in appendix B.

Subdivision (d) of the revised draft of proposed Regulation 1525.4 generally incorporated the provisions of RTC section 6377.1, subdivision (e)(1), establishing the $200 million cap and providing that the exemption does not apply to property under specified circumstances, and clarified how the "calendar year" test in subdivision (e)(1)(A) applies when the partial exemption is only effective for part of a calendar year. Subdivision (e) of the revised draft of proposed Regulation 1525.4 incorporated the provisions of RTC section 6377.1, subdivision (e)(2), prescribing the circumstances under which a purchaser is liable for sales tax.

Subdivision (f) of the revised draft of proposed Regulation 1525.4 clarified the application of the partial exemption provided by RTC section 6377.1 to lease transactions. Subdivision (f) specifically explained when rentals payable will be subject to the partial exemption in circumstances where a lease was entered into prior to the operative date of RTC section 6377.1, for a lease term expiring after the operative date, in a similar manner as Regulation 1532, subdivision (i)(1), clarified the application of the partial exemption provided by RTC section 6378 to the same circumstances. Subdivision (f) also specified how the one-year test period (for purposes of ascertaining the primary use of property) applies in the context of lease transactions.

Subdivision (g) of the revised draft of proposed Regulation 1525.4 clarified that Regulation 1521, *Construction Contractors*, still provides for the basic application of tax to construction contractors. Subdivision (g)(1) explained that a construction contractor performing a construction contract described in RTC section 6377.1, subdivision (a)(4), should obtain a partial exemption certificate (in the form shown in appendix A) from the qualified person, and a construction contractor, purchasing property from a retailer in this state or engaged in business in this state, for use in a qualified construction contract, must timely furnish its own partial exemption certificate to the retailer (in the form shown in appendix B). Subdivision (g)(2) clarified that a construction contractor may independently qualify as a "qualified person" for purposes of the partial exemption. And, subdivision (g)(3) clarified how the $200 million cap applies to fixtures and materials sold or use in the construction of special purposes buildings and foundations.

Finally, subdivision (h) of the revised draft of proposed Regulation 1525.4 clarified that purchasers of qualified tangible personal property may file claims for refund with the Board regarding use tax transactions because consumers are directly liable for use tax. However, only retailers may file claims for refund with the Board regarding sales tax transactions because sales tax is directly imposed on and paid by retailers. Subdivision (h) also provides additional notice that claims for refund of sales and use tax must be timely filed in accordance with RTC section 6902.

Furthermore, Formal Issue Paper 14-001 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised draft of Regulation 1525.4 attached to the issue, except for the following three items:

1. Waste Management's recommendation to include a specific example in subdivision (b)(8)(A) of the regulation explaining when a business in the recycling industry is a "qualified person";
2. The California Taxpayers Association's (CalTax's) recommendation to include alternative tests in subdivision (b)(8)(A)1 to provide that an establishment may be "primarily engaged" based on number of employees, employee hours, number of units produced, or capital investment; and
3. The California Poultry Federation's recommendation that the regulation clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B).

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 14-001 during its Business Taxes Committee meeting on April 22, 2014. During the meeting, the Board heard public comments from Ms. Therese Twomey, CalTax's Fiscal Policy Director, Mr. Joe Vinatieri from Bewley, Lassleben, & Miller LLP, Ms. Nicole Rice, the California Manufacturers & Technology Association's Policy Director, Mr. Bill Mattos, President of the California Poultry

Federation, Mr. Brian Grant, Foster Farms' Tax Director, Mr. Chuck White, Director of Regulatory Affairs for the Department of Waste Management, Mr. Ralph Chandler, Regulatory Affairs Director for the California Refuse and Recycling Coalition, and Mr. Ken Dunham, Executive Director of the West Coast Lumber & Building Material Association. (See the transcript or video for more detail.) The Board also discussed the proposed regulation with Board staff.

During the Business Taxes Committee meeting, the Board also agreed with staff's recommendation to propose to adopt staff's revised draft of Regulation 1525.4, subject to two additional clarifications. First, the Board agreed with CalTax's recommendation to include an alternative test in subdivision (b)(8)(A)1 of the regulation to provide that an establishment may be primarily engaged based on "number of employees" with the condition that the number of employees be "based upon a full-time equivalency." Second, in response to Waste Management's recommendation, the Board agreed to add an example to subdivision (b)(8)(A), to provide that a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are "reasonably" described in a qualifying four digit NAICS industry group. The Board Members unanimously voted to propose the adoption of the regulation, with the two clarifications noted above.

The Board determined that the adoption of the regulation is reasonably necessary for the specific purposes of implementing, interpreting, and making specific the provisions of RTC section 6377.1, prescribing the form of the partial exemption certificates that must be issued to retailers to claim the new partial exemption, and addressing all of the issues (or problems) identified above. The Board further determined that the regulation is reasonably necessary for the specific purposes of clarifying when a purchaser is primarily engaged in a qualifying line of business, and when a person is or is not a qualified person.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";

- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

The adoption of proposed Regulation 1525.4 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to proposed Regulation 1525.4.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-001, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its April 22, 2014, Business Taxes Committee meeting in deciding to propose the adoption of Regulation 1525.4, described above.

ALTERNATIVES CONSIDERED

The Board considered whether to propose to adopt Regulation 1525.4 as recommended by staff in Formal Issue Paper 14-001 during its April 22, 2014, Business Taxes Committee meeting. In addition, the Board considered two reasonable alternatives to proposed Regulation 1525.4, where Board staff and interested parties had different proposed language.

First, RTC section 6377.1, subdivision (b)(6)(A) provides that the term qualified person means a person that is primarily engaged in those lines of business described in NAICS codes 3111 to 3399, inclusive, 541711, or 541712. Board staff suggested that proposed Regulation 1525.4, subdivision (b)(8)(A), clarify that a person may be a qualified person even if there is no applicable six digit NAICS code to describe the person's line of business, provided that their business activities are described in a qualified four digit industry group, without providing any examples. Waste Management suggested alternative language that added an example further clarifying that "the recycling industry will not be precluded from the definition of a '[q]ualified person' for not having a specific four or six digit NAICS code, provided that their activities and/or products are described in a qualified [four] digit [NAICS] industry group." (See Exhibit 4 to Formal Issue Paper 14-001.) After considering the proposed example, the Board (1) revised staff's suggested language to clarify that the business activity must be "reasonably" described in a qualified four digit industry group; (2) included a revised example in subdivision (b)(8)(A) of the proposed regulation, which clarifies that "a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group"; and (3) excluded the reference to "products" from the example.

Second, as explained more fully above, the definition of "qualified person" in RTC section 6377.1, subdivision (b)(6)(A), uses the phrase "primarily engaged," and existing law does not specifically define what is meant by "primarily engaged" for purposes of RTC section 6377.1. Board staff suggested that proposed Regulation 1525.4, subdivision (b)(8)(A)(1), include alternative tests to ascertain if an establishment is primarily engaged in a qualifying line of business based on: (1) gross revenue; (2) operating expenses; (3) employee salaries and wages; or (4) value of production. CalTax suggested alternative language adding, in addition to the tests noted above; (5) number of employees; (6) employee hours; (7) number of units produced; or (8) capital investment. (See Exhibit 3 to Formal Issue Paper 14-001.) After considering whether staff's language excluded persons from the definition of "qualified person" that should qualify for the partial exemption, the Board added one additional test for primarily engaged based on "number of employees," but further clarified that the additional test is "based on full time equivalency."

Furthermore, the California Poultry Federation's suggested that Regulation 1525.4 clarify that the "establishment" concept can apply so that a person with a qualifying establishment can be a "qualified person" for purposes of that establishment, even if the person is otherwise an apportioning trade or business that would be precluded from the definition of qualified person by RTC section 6377.1, subdivision (b)(6)(B). In Formal Issue Paper 14-001, Board staff concluded that the provisions in RTC section 6377.1, subdivision (b)(6)(B) are specific and would not allow staff to apply the establishment concept as suggested by the California Poultry Federation. After considering the California Poultry Federation's suggestion during the April 22, 2014, Business Taxes Committee meeting, several Board Members recommended that the California Poultry Federation seek an amendment to RTC section 6377.1 that would fix the issue identified by staff, and the Board did not make any changes to staff's recommended language for Regulation 1525.4 in response to this suggestion.

During the Board's April 22, 2014, Business Taxes Committee meeting, the Board decided to propose to adopt Regulation 1525.4 as recommended by staff and with the two changes noted above because the Board determined that the adoption of the proposed regulation is reasonably necessary for all the reasons provided above. The Board did not reject any reasonable alternative to proposed Regulation 1525.4 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)(1)

AB 93, as amended by SB 90, added section 6377.1 to the RTC effective July 11, 2013. Section 1 of AB 93 specifies that it is the intent of the Legislature in adding RTC section 6377.1 to exempt manufacturing equipment from state sales and use taxes in order to make California more competitive in attracting new businesses to this state. And, the Board anticipates that RTC section 6377.1 will have some economic impact on business and state revenue.

The Board is proposing to adopt Regulation 1525.4 to implement, interpret, and make specific the provisions of RTC section 6377.1, define and further define statutory terms, including "qualified person," explain when the partial exemption does and does not apply, prescribe the form of the partial exemption certificate that must be provided to the retailer pursuant to RTC section 6377.1, subdivision (c), and provide sample partial exemption certificates to be used for claiming the partial exemption,. In addition, the Board intends to make the sample partial exemption certificates set forth in Appendices A and B to proposed Regulation 1525.4 available to the public on the Board's website.

The Board anticipates that the adoption of proposed Regulation 1525.4 will benefit the Board, Board staff, and persons engaged in manufacturing, research and development, or both by:

- Providing guidance about and promoting awareness of the partial exemption for equipment used primarily in manufacturing and research and development provided by RTC 6377.1, and the requirements to qualify for the partial exemption;
- Implementing RTC section 6377.1, subdivision (c) by prescribing the form of the partial exemption certificate that qualified persons and construction contractors must issue to retailers, and providing sample partial exemption certificates that meets the required form for such persons to use;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(6)(A) by defining what is meant by the requirement that a qualified purchaser be "primarily engaged" in a qualifying line of business;
- Interpreting and making specific RTC section 6377.1, subdivision (b)(7)(A)(iv) by further defining "special purpose buildings and foundations";
- Interpreting and making specific RTC section 6377.1, subdivision (f) by clarifying the application of the partial exemption in the context of certain lease transactions; and
- Interpreting and making specific RTC section 6377.1, subdivision (a)(4) by clarifying the application of the partial exemption to transactions involving construction contracts.

All of the provisions in proposed Regulation 1525.4 are fully consistent with current law, including RTC section 6377.1, and there is nothing in proposed Regulation 1525.4 that would significantly change how individuals and businesses would generally behave in response to RTC section 6377.1 in the absence of the proposed regulatory action. Therefore, the Board estimates that the proposed regulation will not have a measurable

economic impact on individuals and business that is in addition to whatever economic impact RTC section 6377.1 will have on individuals and businesses. And, the Board has determined that the proposed adoption of Regulation 1525.4 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed regulation will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars ($50,000,000) during any 12-month period.

In addition, the Board has determined that proposed Regulation 1525.4 does not impose any costs on any persons, including businesses, which are not already imposed by RTC section 6377.1, and the Board has determined that there is nothing in proposed Regulation 1525.4 that would impact revenue. Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of proposed Regulation 1525.4 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, proposed Regulation 1525.4 will not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of proposed Regulation 1525.4 will not affect the benefits of the regulation to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of proposed Regulation 1525.4 will not have a significant adverse economic impact on business.

The adoption of proposed Regulation 1525.4 may affect small businesses.

Proposed Text of

California Code of Regulations, Title 18, Section 1525.4,

Manufacturing and Research & Development Equipment,

(A new regulation to be added to the California Code of Regulations)

1525.4. Manufacturing and Research & Development Equipment.

(a) Partial Exemption for Property Purchased for Use in Manufacturing and Research and Development. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales and purchases, including leases, of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(1) Qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(2) Qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Qualified tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any qualified tangible personal property described in subdivision (a)(1) or (2).

(4) Qualified tangible personal property purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, provided that the qualified person will use the resulting improvement on or to real property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) Definitions. For the purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or tangible personal property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) "Packaging" means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer shall not be considered to be "packaging" for purposes of this regulation.

(4) "Pollution control" means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) "Primarily" means 50 percent or more of the time.

(6) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form, including packaging as defined in subdivision (b)(3), if required. "Process" includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form,

including packaging as defined in subdivision (b)(3), if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) "Processing" means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property.

(8) (A) "Qualified person" means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition. With respect to Codes 3111 to 3399, a person will not be precluded from the definition of a "qualified person" when there is no applicable six digit NAICS code to describe their line of business, provided that their business activities are reasonably described in a qualified four digit industry group. For example, a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group. For the purpose of this subdivision:

1. A qualified person may be "primarily engaged" either as a legal entity or as an establishment within a legal entity. "Legal entity" means "person" as defined in RTC section 6005.

A person is "primarily engaged" as a legal entity if, in the prior financial year, the legal entity derives 50 percent or more of gross revenue (including inter-company charges) from, or expends 50 percent or more of operating expenses in a line of business described in Codes 3111 to 3399, inclusive, 541711 or 541712 of the NAICS. For example, a legal entity is a qualified person primarily engaged in a qualifying line of business if the legal entity's gross revenue from manufacturing constitutes 50 percent or more of the total revenue for the legal entity. For purposes of research and development activities, revenues could be derived from, but are not limited to, selling research and development services or licensing intellectual property resulting from research and development activities.

A person is "primarily engaged" as an establishment if, in the prior financial year, the establishment derives 50 percent or more of gross revenue (including inter-company and intra-company charges) from, or expends 50 percent or more of operating expenses in a qualifying line of business. Alternatively, an establishment is "primarily engaged" if, in the prior financial year, it allocates, assigns or derives 50 percent or more of any one of the following to or from a qualifying line of business: (1) employee salaries and wages, (2) value of production, or (3) number of employees based on a full-time equivalency.

For purposes of this test, the gross revenues may be derived from a combination of qualified manufacturing lines of business and from qualified research and development lines of business. For example, if a company derives 40% of its gross revenues from qualified manufacturing activities and 40% from non-qualified manufacturing activities; but, the remaining 20% of its gross revenues are derived from qualified research and development contracts, the company would qualify because overall, 60% of the gross revenues are from qualifying activities.

Similarly, the test for operating expenses from qualifying manufacturing or research and development lines of business cited in the qualifying NAICS codes would be considered in combination.

There may be more than one qualifying establishment within a legal entity.

In the case of a nonprofit organization or government entity, "primarily engaged" with regard to gross revenue means 50 percent or more of the funds allocated to the entity or establishment are attributable to a qualifying line of business.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

2. For purposes of this subdivision, "establishment" includes multiple or single physical locations (including any portion or portions thereof), and those locations or combinations of locations (including any portion or portions thereof) designated as a "cost center" or "economic unit" by the taxpayer, where a qualified activity is performed, and for which the taxpayer maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity. A physical location may be described in more than one NAICS code.

3. An entity or establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in research and development, provided all other requirements for the exemption are met. An entity or establishment primarily engaged in research and development may purchase qualified tangible personal property subject to the partial sales and use tax exemption for use in manufacturing, provided all other requirements for the exemption are met. Where a person is primarily engaged as a legal entity, that person shall be considered a "qualified person" for purposes of this regulation for all purchases made by the legal entity, provided all other requirements of the exemption are met. Where a person conducts business at more than one establishment then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712.

(B) Notwithstanding subdivision (b)(8)(A), "qualified person" does not include:

1. An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of RTC section 25128.

2. A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of RTC section 25128 if it were subject to apportionment pursuant to RTC section 25101.

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity as defined in subdivision (d) of RTC section 25128.

(9) (A) "Qualified tangible personal property" includes, but is not limited to, all of the following:

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, computers, data-processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the qualified person or another party.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation underlying the building that is specifically designed and constructed or

reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the structure from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a qualified person may establish that a portion of the structure qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(B) "Qualified tangible personal property" does not include any of the following:

1. Consumables with a useful life of less than one year.

2. Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process. The extraction process includes such severance activities as mining, oil and gas extraction.

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified person does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." Tangible personal property that the qualified person treats as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this regulation. Tangible personal property that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this regulation.

(c) Partial Exemption Certificate.

(1) In General. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision (b)(8)(A). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will be liable for payment of sales tax, with applicable interest as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, or if the retailer receives a certificate from a contractor purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(5), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used by construction contractors as an exemption certificate when they are purchasing qualified tangible personal property for use in a construction contract for a qualified person.

(2) Blanket Partial Exemption Certificate. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificate forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) Form of Partial Exemption Certificate. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition), or

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (7)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) Retention and Availability of Partial Exemption Certificates. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

(5) Good Faith. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3).

(d) When the Partial Exemption Does Not Apply. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

For the purposes of this subdivision, "calendar year" includes the period July 1, 2014 to December 31, 2014, as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed $200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the $200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person may purchase up to $200,000,000 in qualified tangible personal property in the three months of 2016 they were in business.

(2) The sale or storage, use, or other consumption of property that, within one year from the date of purchase, is removed from California, converted from an exempt use under

subdivision (a) to some other use not qualifying for exemption, or used in a manner not qualifying for exemption.

(e) Purchaser's Liability for the Payment of Sales Tax. If a purchaser certifies in writing to the seller that the tangible personal property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and the purchaser exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subdivision (d)(1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

(f) Leases. Leases of qualified tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

(g) Construction Contractors. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

(1) Partial Exemption Certificates. As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a

qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

If a contractor accepts a certificate from a qualified person for the construction of a special purpose building or foundation and it is later determined that the building or foundation is not a qualifying structure as provided in subdivision (b)(9)(A)4., the qualifying person will be liable for the tax as provided in subdivision (e). If a contractor issues a certificate to its vendor to purchase tangible personal property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax as provided in subdivision (e).

(2) Construction Contractors as Qualified Persons. Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) may purchase property subject to the partial sales and use tax exemption provided all requirements for exemption are met. Like any other qualified person, a contractor making purchases qualifying for the exemption is subject to the $200,000,000 limit provided in (d)(1) with regard to the contractor's purchases for his or her own use.

(3) $200,000,000 Limit. As explained in subdivision (d)(1), the $200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) Claim for Refund. Qualified purchasers, or contractors purchasing qualified tangible personal property for use in the performance of a construction contract for a qualified person, who paid tax or tax reimbursement to the seller or the Board may file a claim for refund with the Board if the purchase was a use tax transaction. However, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale and the qualified purchaser must issue the seller a partial exemption certificate. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6377.1, Revenue and Taxation Code.

Appendix A

PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

☐ 1. for manufacturing, processing, refining, fabricating, or recycling;

☐ 2. for research and development;

☐ 3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or**

☐ 4. as a special purpose building and/or foundation.

Description of qualified tangible property purchased or leased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the tangible personal property is so purchased, removed, converted, or used if:

- the purchase exceeds the $200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- converted for use in a manner not qualifying for the exemption; **or**
- used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Appendix B

CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

Description of qualified tangible property purchased[1]:

If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file.

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)[2] or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

[1] See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

[2] Published by the US Office of Management and Budget, 2012 edition.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1525.4

Title: *Manufacturing and Research & Development Equipment*

Preparation: Andrew Kwee
Legal Contact: Andrew Kwee

Proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*, implements, interprets, and makes specific Revenue and Taxation Code section 6377.1's partial exemption for the sale and use of equipment used primarily in manufacturing, and research and development.

History of Proposed Regulation:

July 17-18, 2014	Public Hearing
May 30, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
May 20, 2014	Notice to OAL
April 22, 2014	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA