

347.0000 MANUFACTURING EQUIPMENT—Regulation 1525.2

347.0150 Business Activity Partially Nonmanufacturing. A taxpayer operates a photocopying and computer printing business. Photocopying falls within Code 7334, nonmanufacturing Standard Industry Classification (SIC) Code. The “manufacturing equipment” exemption applies only to equipment used in manufacturing activities, SIC codes between 2000 and 3999. If the computer printing activity, a manufacturing activity, is significant within the meaning of Regulation 1525.2(c)(5)(B)(2)(a), equipment purchased for use in that activity qualifies for the exemption provided in section 6377 if the other requirements for exemption are met. 1/26/95.

347.0200 Commence Business Activity. An individual has been employed for many years as a mold maker for Company A. In July 1994, the individual acting in the capacity of a sole proprietor/independent contractor and not as an employee of Company A made molds for Company B using Company A’s equipment. The individual also applied for a seller’s permit in July 1994 specifically for this operation. In August 1995, the individual bought mold making equipment and set them up in his garage. In February 1996, he quit his job with Company A and started his own business as a mold maker.

A person begins a trade or business activity when that person first conducts the activities for which that trade or business was organized. This can occur at any time based on the nature of that person’s activities. At a minimum, the acquisition of operating assets necessary for the type of business contemplated constitutes “commencing activities.” However, the acquisition of operating assets is not the sole factor in determining when a person first conducts trade or business activities. The true test is when that person first conducts the activities for which it was organized.

Here, the individual first undertook activities in the trade or business activity of a mold maker in July 1994 when he applied for a seller’s permit to make molds and contracted with Company B to provide it with molds. The fact that he did not acquire his own operating assets until August 1995 does not alter the fact that the individual’s mold making activities actually began in July 1994. Therefore, the commencement date for the business activity is July 1994 and the partial sales and use tax exemption certificate is valid for a three-year period commencing on that date. 7/9/97.

347.0250 Corporate Division Opening New Plant. A taxpayer is a corporation who has been manufacturing floppy disks and audio tapes in California for several years. In early 1995, the taxpayer decided to open a new CD ROM manufacturing operation at another location in California. The new CD ROM facility maintains separate books and records and operates as a separate operating division under the corporate umbrella.

Section 6377 makes a distinction between persons who are or were previously engaged in a trade or business inside the state and those that are not for purposes of determining “qualified person” status. A new trade or business is generally one which a person (or any related person) has not engaged in within the preceding 36 months inside California or which is classified in a different Standard Industrial Classification Manual (SIC manual) code division than the person’s (or any related person’s) current or prior trade or business activities in this state.

The taxpayer has been engaged in manufacturing activities inside California within the previous 36 months; these activities consist of manufacturing floppy disks and audio tapes described in the SIC manual under code 3695 as “Magnetic and Optical Recording Media.” The new CD ROM operation is a part of the same corporation that has been engaged in manufacturing operations covered by the same divisions of the SIC manual. As such, the taxpayer’s new CD ROM operation does not qualify as a new trade or business for purposes of the partial sales and use tax exemption. 2/6/96.

347.0475 Lease of Manufacturing Equipment. Regulation 1525.2(i)(1) provides that the partial sales and use tax exemption applies to taxable rental receipts which are paid by a qualified person on the lease of tangible personal property used in a manufacturing activity. This partial sales and use tax exemption is not available to lessors who lease property to qualified persons when the lessor elects to pay sales tax reimbursement at the time of acquisition of the property or pay use tax measured by the purchase price of

the property. The application of the partial sales and use tax exemption is only available with respect to the lease transaction itself and not with respect to the lessor's acquisition of the property. 9/4/95.

347.0515 Lessee—Not Pre-Qualified. Where a lessor leases property to a qualified person (as defined in Regulation 1525.2) in which the lease is regarded as a continuing sale and purchase, the lessee owes the difference between the full amount of tax on the rental receipts and the amount of the partial sales and use tax exemption. The lessor is required to collect this amount of tax from the lessee and pay it to the Board.

If a lessee is not pre-qualified by this Board, the lessor must collect the entire amount of tax due on rental receipts subject to tax.

If the Board later revokes a lessee's section 6377 partial exemption certificate, the lessee is responsible for paying the tax (plus interest) which was previously exempted by section 6377. 9/4/95.

347.0535 Manufacturer's Partial Exemption—Transportation Equipment. A manufacturer operates four separate yet integrated plants located within several miles of each other. Each plant performs a different segment of the manufacturing process. No single plant manufactures a finished commercially marketable product. After each stage of manufacturing, the unfinished product is shipped to the next plant for further processing using large trucks or some other type of mobile transportation equipment and loading and unloading equipment such as forklifts, containers, etc. The manufacturer believes that the property used to transport the unfinished materials between the various plants should be eligible for the partial exemption from sales and use tax because it should be treated the same way as equipment that moves materials along one continuous production line at a single geographic manufacturing location.

Regulation 1525.2 (c) (10) (A) specifically identifies belts, shafts, moving parts, operating structures, conveyance systems and assembly lines within the definition of property subject to the partial exemption. It does not include items such as trucks, mobile transportation equipment or other property used to store or transport unfinished goods between two distinct geographic locations. The transportation of raw materials to or between each facility does not constitute a manufacturing activity for purposes of section 1525.2 and does not qualify for the partial exemption. 09/18/00. (2001-3).

347.0540 Manufacturing Activity. An out-of-state developer and manufacturer of computer disk drives began contracting with various California companies for the manufacture of its finished products. The out-of-state firm provided the manufacturing equipment, raw materials, and the technical specifications for the manufacture of these items by the California companies. The California companies provide manufacturing labor and the facilities necessary to manufacture the finished items.

Based on these facts, the California companies contracting with the out-of-state firm are performing the manufacturing of the finished products. These companies may qualify for the partial exemption if they meet all the requirements of section 6377 and Regulation 1525.2. The out-of-state firm does not qualify for the partial exemption merely by providing equipment, materials and specifications to these companies. That is, the out-of-state firm's operations inside this state do not fall within SIC code operations 2011 through 3999 by way of its contracts with the California companies. 3/10/97.

347.0675 New Trade or Business. Corporation A has never been involved in any manufacturing activities nor in any trade or business classified under the manufacturing division of SIC Code manual. If, at some future date, Corporation A or a wholly owned subsidiary undertakes a "new" manufacturing trade or business under SIC Code No. 2869, Corporation A will not then be disqualified solely due to corporation A's prior operation of a business that was classified under the "Nonclassifiable Establishments" or "Engineering Services" section of the SIC Code manual. 1/18/95.

347.0676 New Trade or Business. A taxpayer is constructing a manufacturing facility in California. It began construction of this facility after January 1, 1994. Neither the taxpayer nor any related party have owned or operated any manufacturing facilities within California within the last three years. The taxpayer has a sales office located in California, but only engages in sales solicitation from this office.

Since the sales operations from the California sales office fall within the nonmanufacturing SIC division F, “Wholesale Trade” (durable and nondurable goods), the taxpayer’s activities inside this state do not constitute a manufacturing operation previously undertaken in this state. Therefore, the taxpayer is not precluded from qualifying as a new trade or business for purposes of Revenue and Taxation Code section 6377 based on its current and past sales operations inside this state. 11/5/96.

[347.0677](#) **New Trade or Business.** Corporation A is an out-of-state manufacturer of food products who is considering building a manufacturing facility in California. It sells a majority of its product to Corporation B, a related company. Both Corporation A and Corporation B are wholly owned subsidiaries of the same foreign corporation. Corporation B, a California corporation, is headquartered in California and has two branch offices located in California. Corporation A is engaged in manufacturing as defined in Code 2035 of SIC. Corporation B is engaged in a wholesale trade as defined in Code 5140 of the SIC manual. Corporation B has production agreements with two unrelated companies X and Y. Corporation B furnishes Company X with a product it purchases from Corporation A. Company X mixes the product with other products which it produces. The resulting bulk mixture is shipped to Company Y which breaks the bulk into smaller packages. The product is then shipped to rented warehouses for distribution and sale. One of Corporation B’s employees is responsible to oversee and coordinate the production at Company X. Corporation B does not prepare separate financial statements or employment reports related to this single employee’s activities.

Under Standard Industrial Classification (SIC) manual, packaging and repackaging operations of Corporation B are not manufacturing operations generally consisting of the mechanical or chemical transformation of materials or substance into new products (See p. 67 and 68 SIC manual). Therefore, Corporation A is not precluded from qualifying as a new trade or business for purposes of the partial sales and use tax exemption provided under section 6377. Thus, the partial sales and use tax exemption would apply to property purchases by Corporation A for use primarily for manufacturing, processing, refining, fabricating, recycling, research, and development and the repair of qualified property. 4/9/96; 5/9/96.

[347.0730](#) **Partial Exemption—Leasing Transactions.** The partial exemption provided in section 6377(a) is available only to the taxable lease transaction itself and not with respect to the lessor’s acquisition of the property. The partial exemption is not available to the lessors who lease to qualified persons nor to the vendor of such lessors when the lessor elects to pay tax at the time of purchase. 10/17/95.

[347.0750](#) **Pre-Qualified Person.** A nonprofit benefit corporation was formed for the purpose of demonstrating a solar generated hydrogen refueling station, bringing clean fuel technologies to the marketplace, and making the public aware of clean fuel technologies.

In February 1994, it was awarded a U.S. Government grant to demonstrate a solar generated hydrogen refueling station to be located in California. The project will use solar photovoltaics to generate energy for use in a hydrogen gas generating station. The facilities consist of a photovoltaic array which is used to generate power and electrolyses which are integrated with the photovoltaics to manufacture hydrogen. The power from the photovoltaic arrays is used to electrolytically manufacture hydrogen gas which will be used as an ultra low emission and zero emission fuel for specially converted vehicles. The corporation does not hold a seller’s permit or maintain a consumer use tax account.

Since the corporation does not maintain a seller’s permit or consumer use tax account and did not apply (or receive) a partial sales and use tax exemption certificate from the Board as required by Regulation 1525.2(f), the sale of the equipment to the corporation does not qualify for the partial sales and use tax exemption. Even if the corporation has been prequalified by the Board, the purchase of piping and tanks for storage of hydrogen would not qualify for the partial sales and use tax exemption since these items are used for the storage of hydrogen and not for the processing of altering raw materials into a complete form. (Regulation 1525.2(a)(1).) 11/30/95.

[347.0810](#) **Qualified Person—Subsidiary.** A firm which has been engaged in food product manufacturing in California for a number of years, creates a new subsidiary to engage in the manufacture of animal feed from other food by-products.

The parent's operations come within the Standard Industrial Classification Code (SIC) manual industry code 2096. The subsidiary's operations come within the SIC 2898. Both of these codes are within division "D" of SIC manual. Section 6377 provides that a "qualified person" must be in a different division of the SIC code. The plain language of statute and the structure of the manual precludes interpreting the term "division" to mean industry code. Thus, the subsidiary is not a "qualified person." 2/26/96.

[347.0860](#) **Recycling of Property.** A company's "repairing/dismantling" operations involve the disassembly of metal parts for sale to a recycling plant and not any actual reprocessing or transformation of scrap parts to other raw materials. This type of activity does not qualify as "recycling" and, therefore, does not qualify for the "repairing/dismantling" partial sales tax exemption set forth in section 6377. 10/24/94.

347.0865 **Refunds for Manufacturing Partial Exemption.** In June 1993, a manufacturing company ordered equipment necessary to begin a new manufacturing business in California. Some of the equipment arrived in December 1993 and was placed in operation in January 1994. The Company applied for the manufacturer's partial exemption and at the same time requested a refund for tax paid on its purchases of equipment from the first quarter 1994 to the first quarter 1997.

Acquiring operating assets necessary to start the business is considered "commencing activities." (See Regulation 1525.2 (c)(6)(A) 1.) The partial exemption from sales and use tax for purchases of manufacturing equipment under section 6377 was operative January 1, 1994. Because the Company commenced activities in 1993, it does not qualify for the partial exemption and is not entitled to a claim for refund for tax or tax reimbursement paid based on the partial exemption. 1/23/01. (2002-1).

347.0875 **Related Company in Similar Business.** An existing company related to a newly-formed company has been operating in the state within the same division of the Standard Industry Classification Code. The new company does not qualify for exemption provided for in section 6377 even if the existing company uses different technologies and manufactures different products. 3/10/95.

[347.0878](#) **Related Corporations.** Corporations A and B are "related persons" within the meaning of Internal Revenue Code sections 267 and 318. Corporation A only maintained a sales employee inside California and the operations of this sales representative fell within the nonmanufacturing SIC division f, "Wholesale trade," involving the wholesale distribution of durable and non-durable goods. Corporation B's activity in this state consist of selling equipment, parts, and service/repair. Corporation B has not engaged in a manufacturing operation inside this state as defined in SIC codes 2000 to 3999 within the previous 36 months.

Based upon the present and past operation of Corporations A and B, they are not precluded from qualifying as a "new trade or business" under Regulation 1525.2. 9/15/97.

[347.0890](#) **Research and Development Activities.** A taxpayer, who is prequalified for the partial exemptions under section 6377, regularly withdraws tangible personal property from its resale inventory for use in R&D activities. The taxpayer's R&D activities come within the provisions of Internal Revenue Code section 174 and the taxpayer self-reports tax on the cost of this property.

Under these facts, the taxpayer is entitled to take a partial exemption against the amount of tax it self-reports when it withdraws its ex-tax inventory for use in its R&D activities. (Regulation 1525.2(a)(2).) The taxpayer must report the tax it owes on this property and claim the partial exemption on the return for the period in which it removes the property from its ex-tax inventory and uses it in the R&D activities. 1/21/97.

[347.1000](#) **Special Purpose Buildings.** Components of a methanol plant, including the concrete pads (foundations), qualify as special purpose buildings and foundations under section 6377 as long as the components and foundations are used as an integral part of the manufacturing process. Therefore, the plant and concrete pads are tangible personal property for purposes of the partial exemption from sales and use taxes (6% for transactions in 1994 and 5% for transactions in 1995 and thereafter). Tanks and their pads which are merely used for warehousing purposes do not qualify for the exemption. 11/1/94.