State of California | Board of Equalization

Memorandum

To : Mr. Ramon J. Hirsig
Executive Director – MIC: 73

Date: November 25, 2004

From : Randie L. Henry, Deputy Director
Sales and Use Tax Department– MIC: 43

Subject : Regulation 1525.3, *Manufacturing Equipment--Leases of Tangible Personal Property*
Chief Counsel's Rulemaking Calendar - December 14, 2004

I am requesting your approval to place proposed amendments to Regulation 1525.3, *Manufacturing Equipment -- Leases of Tangible Personal Property*, on the Chief Counsel's Rulemaking Calendar for Board approval.

The reason for the revision is as follows: Revenue and Taxation Code section 6377 provided that the partial tax exemption would cease to be operative if the total employment in this state, as determined by the Employment Development Department (EDD), on the preceding January 1, does not exceed by 100,000 jobs the total employment in this state on January 1, 1994. According to EDD, non-aerospace manufacturing jobs fell below the 100,000 threshold on January 1, 2003. As a result, all provisions of this regulation cease to be operative as of January 1, 2004. This means that retailers and qualified persons may not accept or claim any Section 6377 Manufacturer's Exemption Certificates for a sale or a use made after December 31, 2003. For legal and auditing purposes, this regulation will remain in the Business Taxes Law Guide for a period of five years.

Attached are proposed amendments to the regulation, which reflect the above changes.

We request your approval to place the matter on the Chief Counsel's Rulemaking Calendar on December 14, 2004, for Board authorization to amend the regulation in accordance with Title 1, California Code of Regulations, section 100. Legal Department staff has advised us that these changes are without regulatory effect and are not subject to the normal public hearing process.

If you have any questions regarding this request, please let me know or contact Ms. Mariflor Jimenez at (916) 324-2952.

Attachment

Recommendation by:

Jeff McGuire for

Randie L. Henry, Deputy Director

Approved:

Ramon J. Hirsig, Executive Director

Approved:

Timothy Boyer

Timothy Boyer, Chief Counsel
Legal Department

BOARD APPROVED
At the _____ Board Meeting

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Deborah Pellegrini, Chief
Board Proceedings Division

cc (all with attachments)
Mr. Timothy Boyer (MIC 83)
Ms. Deborah Pellegrini (MIC 81)
Ms. Janice Thurston (MIC 82)
Ms. Trecia Nienow (MIC 82)
Mr. John Waid (MIC 82)
Mr. Jeffrey L. McGuire (MIC 92)
Mr. Geoffrey E. Lyle (MIC 50)
Acting Supervisor, BTC Team (MIC 50)
Ms. Cecilia Watkins (MIC 50)
Ms. Mariflor Jimenez (MIC 50)

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Proposed Regulation 1525.3. MANUFACTURING EQUIPMENT--LEASES OF TANGIBLE PERSONAL PROPERTY.

(a) GENERAL APPLICATION TO LEASES. Leases of tangible personal property which are classified as "continuing sales" and "continuing purchases" of tangible personal property, in accordance with Regulation 1660, "Leases of Tangible Personal Property-In General," may qualify for the partial exemption from tax for manufacturing equipment, under the conditions set forth in paragraph (i)(1) of Regulation 1525.2, "Manufacturing Equipment." Lease transactions which qualify for the partial exemption are taxed at the rate specified in Regulation 1525.2, paragraph (a).

(b) RECHARACTERIZATION. With respect to transactions which the parties denominate as a "lease," but which are recharacterized for sales and use tax purposes either as sales at their inception, pursuant to Regulation 1641, "Credit Sales and Repossessions," paragraph (b), or as sales under a security agreement, Regulation 1660, "Leases of Tangible Personal Property—In General," paragraph (a)(2), the transactions may qualify for the partial exemption, in accordance with Regulation 1525.2.

(c) CONTINUATION OF PARTIAL EXEMPTION. Where possession of tangible personal property is transferred to a qualified person as defined in paragraphs (c) and (d) of Regulation 1525.2 and pursuant to a lease agreement classified as a continuing sale and continuing purchase, lease receipts shall remain partially exempt for a period of six years from the date of the inception of the lease whether or not the lessee remains as a qualified person throughout the six year period. At the close of the six year period from the date of the inception of the lease, lease receipts are subject to tax without exemption.

(d) LEASES OF TAX-PAID PROPERTY. The partial exemption is not available to lessors who lease to qualified persons or to vendors to such lessors when the lessor elects to pay sales tax reimbursement at the time of acquisition of the property or pays use tax measured by the purchase price of the property.

(e) MANUFACTURERS WHO LEASE QUALIFIED PROPERTY. A lease of tangible personal property by the manufacturer of that property is ordinarily regarded as a "continuing sale" and "continuing purchase" in accordance with Regulation 1660, "Leases of Tangible Personal Property - In General." Nevertheless, beginning January 1, 1997, a lessor of tangible personal property described in sections 17053.49 or 23649 of the Revenue and Taxation Code, who is the manufacturer of that property and who leases that property to a qualified person, as defined in section 17053.49 or 23649 of the Revenue and Taxation Code, in a form that is not substantially the same form as acquired, may, in lieu of reporting tax measured by the rentals payable, elect to pay tax measured by the cost price of that property where the election is made on or before the due date of the return for the period in which the property is first leased to the qualified person. The election shall be made by reporting use tax measured by the cost price of that property on the return for that period. The election shall not be revoked with respect to the property as to which it is made. The lease of that property for which an election is made to report and pay tax on the cost price of that property shall thereafter be excluded from the classification of a "continuing sale" and "continuing purchase."

For purposes of this subdivision, "cost price" means the price at which similar property has been previously sold or offered for sale. If that property has not been previously sold or offered for sale, then the cost price shall be deemed to be the aggregate of the following:

(1) Cost of materials.

(2) Direct labor.

(3) The pro rata share of all overhead costs attributable to the manufacture of the property.

(4) Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the factors listed in subsections (1) to (3), inclusive.

(f) OPERATIVE DATE. All provisions of this regulation cease to be operative as of January 1, 2004, as provided by Revenue and Taxation Code section 6377(g). Retailers and qualified persons may not accept or claim any Section 6377 Manufacturer's Exemption Certificates for a sale or use made after December 31, 2003.

Authority Cited: Section 7051, Revenue and Taxation Code.

Reference: Section 6377, Revenue and Taxation Code.

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The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.