STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Introduced:	**07/15/09**	Bill No:	**ABx4 31**
Tax:	**Sales and Use**	Author:	**Torrico, et al.**
Related Bills:			

BILL SUMMARY

This bill would, beginning January 1, 2010, provide a state, local, and district sales and use tax exemption for purchases of qualifying tangible personal property by persons engaged in automobile manufacturing, as specified and defined.

ANALYSIS

CURRENT LAW

Under current law, entities engaged in manufacturing activities that purchase machinery and equipment and other items for use in the conduct of their manufacturing activities are required to pay tax on their purchases to the same extent as any other person either engaged in business in California or not so engaged. Current law does not provide special tax treatment for purchases of equipment used by manufacturers.

PROPOSED LAW

This bill would add Section 6356.7 to the Sales and Use Tax Law to provide an exemption from the state and local sales and use tax operative January 1, 2010 for the following purchases by an automobile manufacturer:

- Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures.
- All equipment or devices used or required to operate, control, regulate, or maintain the machinery, as specified.
- Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, or fabricating process, or that constitutes a research or storage facility used during the manufacturing process.

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

BACKGROUND

For a ten-year period ending December 31, 2003, the law provided a partial sales and use tax exemption for purchases of equipment and machinery by new manufacturers, and income and corporation tax credits for existing manufacturers' investments (MIC) in equipment. Manufacturers were defined in terms of specific federal Standard Industrial Classification codes, and automobile manufacturers were included within the group of qualifying manufacturers. The exemption applied to the state tax portion of the statewide rate for sales and purchases of qualifying property, and the in lieu income tax credit was equal to six percent of the amount paid for qualified property placed in service in California. Qualified property essentially was depreciable equipment used primarily for manufacturing, refining, processing, fabricating or recycling; for research and development; for maintenance, repair, measurement or testing of qualified property;

and for pollution control meeting state or federal standards. Certain special purpose buildings were included as "qualified property." New manufacturers could receive either the benefit of the exemption, or claim the income tax credit. However, existing manufacturers could only receive the benefit of the income tax credit.

This partial sales and use tax exemption and income tax credit had a conditional sunset date. The sunset was to occur in any year following a year when manufacturing employment (as determined by the Employment Development Department) did not exceed January 1, 1994 manufacturing employment by more than 100,000. On January 1, 2003, manufacturing employment (less aerospace) did not exceed the 1994 employment number by more than 100,000 (indeed, it was *less* than the 1994 number by over 10,000), and therefore the MIC and partial sales tax exemption sunsetted at the end of 2003.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in order to develop incentives to keep open the New United Motor Manufacturing, Inc. (NUMMI) plant in Fremont. NUMMI was established in 1984 as a joint venture of General Motors and Toyota, and manufactures the Toyota Tacoma, the Toyota Corolla, and the Pontiac Vibe. General Motors Corporation’s recent announcement that it is pulling out of this joint venture, and discontinuing the manufacture of the Pontiac Vibe, has resulted in concern over closure of the plant. The bill is intended to assist in saving the 5,000 jobs at the plant itself, as well as the estimated 25,000 other jobs of California NUMMI suppliers.

2. **“Automobile manufacturer” should be defined.** Under the language of the bill, persons engaged in any of the activities listed that fabricate automobile parts – even minimally – could argue that they qualify for the proposed exemption for their purchases of machinery and equipment used in those activities (such as auto repair shops, auto dismantlers, etc.). In order to properly describe the industry group intended to benefit from the proposed exemption and minimize the revenue impact, a reference to persons primarily engaged in Code 3361111 of the North American Industry Classification System for purposes of defining “automobile manufacturers” is recommended. Reference to this code, however, would include manufacturers of electric vehicles as well.

3. **The bill defines tangible personal property to include special purpose buildings and foundations.** However, a manufacturer would not ordinarily buy a special purpose building or a foundation in its completed form. Rather, a manufacturer generally hires a contractor to acquire the materials to build and install the buildings and foundations. It is therefore suggested that the bill clarify that the proposed exemption would apply to purchases of tangible personal property purchased for use by a contractor purchasing that property either as an agent of the manufacturer or for the contractor’s own account and subsequent resale to the manufacturer for use in the performance of a construction contract for the manufacturer who will use the special purpose buildings and foundations as an integral part of the manufacturing process.

4. **Should the exemption contain a recapture provision?** The author may wish to incorporate a sales and use tax recapture provision in cases where the property is transferred outside this state or committed to a use other than auto manufacturing after the property is placed in service. For example, under the bill, if an auto manufacturer acquired the equipment for use in California without payment of sales or use tax and after a brief use of the equipment, subsequently closed down and transported the equipment for use at an out-of-state facility, the auto manufacturer would be entitled to retain the sales and use tax exemption. A recapture provision would essentially disallow the exemption if, within a specified period of time, the equipment is transported outside this state or converted to a use other than manufacturing.

COST ESTIMATE

The Board would incur absorbable costs to administer this measure. These costs would be attributable to, among other things, identifying and notifying qualifying auto manufacturers and auditing claimed amounts.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The *Annual Survey of Manufactures* (ASM), conducted by U.S. Census Bureau, provides sample estimates of statistics for all manufacturing establishments with one or more paid employees. Data is presented at the North American Classification System (NAICS) levels. NAICS 3361 is the motor vehicle manufacturing classification. We used NAICS 3361 as the basis for our estimate.

For NAICS 3361-California, capital expenditures data for machinery and equipment and buildings and structure was withheld to avoid disclosing data for individual companies. Capital expenditures by automotive manufacturers in the U.S. in 2006 on machinery and equipment, buildings and structures, and computers amounted to $7.8 billion. The ratio of U.S. expenditures to total U.S. value of shipments in 2006 is estimated to be 3% ($7.8 billion in capital expenditures / $262 billion in total value of shipments = 3%).

Based on the above 3% ratio and total California shipments of $7.5 billion in 2006 and taking into consideration a continuous decline in car production in California in recent years, it is estimated that capital expenditures on machinery and equipment, buildings and structures, and computers by automotive manufactures in California in 2009-10 would amount to $154 million (($7.5 billion in total value of shipments × 3%) × 31% in estimated production decline = $154 million).

REVENUE SUMMARY

The direct revenue loss from exempting tangible personal property purchased by California automotive manufacturers from the sales and use tax would amount to an estimated $14 million annually, as follows:

	Revenue Loss ($ thousands)
State (6.00%)	$ 9,247
Fiscal Recovery Fund (0.25%)	385
Local (2.00%)	3,082
Special District (0.75%)	1,156
	$13,870

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