ASSEMBLY BILL No. 1057

Introduced by Assembly Member Olsen
(Coauthor: Senator Berryhill)

February 18, 2011

An act to add and repeal Section 6377.1 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

legislative counsel's digest

AB 1057, as introduced, Olsen. Sales and use taxes: exemption: manufacturing.

The Sales and Use Tax Law imposes a tax on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state. That law provides various exemptions from those taxes.

The bill would exempt from those taxes, on and after January 1, 2014, and before January 1, 2020, the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property purchased by a qualified person for use primarily in the manufacturing process, as specified, for use in research and development, as specified, or for use in air pollution mitigation, as provided. This bill would also exempt the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property purchased for use by a contractor for specified purposes.

This bill would require the Legislative Analyst's Office to complete and distribute a report to the Legislature on the effect of this exemption by January 1, 2019.

The Bradley-Burns Uniform Local Sales and Use Tax Law authorizes counties and cities to impose local sales and use taxes in conformity with the Sales and Use Tax Law, and existing law authorizes districts, as specified, to impose transactions and use taxes in accordance with the Transactions and Use Tax Law, which conforms to the Sales and Use Tax Law. Exemptions from state sales and use taxes are incorporated into these laws.

This bill would specify that this exemption does not apply to local sales and use taxes, transactions and use taxes, and specified state taxes from which revenues are deposited into the Local Public Safety Fund, the Local Revenue Fund, or the Fiscal Recovery Fund.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares the following:

(a) California has the highest sales tax in the nation.

(b) California is one of only a few states that tax the manufacturing of equipment.

(c) California has the fourth worst tax system for jobs in the entire country.

(d) California has the third highest unemployment rate in the country.

SEC. 2. Section 6377.1 is added to the Revenue and Taxation Code, to read:

6377.1. (a) On and after January 1, 2014, there are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage, use, or other consumption in this state of, any of the following:

(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 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 property to its completed form, including packaging, if required.

(2) 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 who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a storage facility for use in connection with the manufacturing process.

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

(4) Qualified tangible personal property purchased for use by a qualified person for use primarily to mitigate air pollution, as required by the Environmental Protection Agency and the State Air Resources Board.

(b) For purposes of this section:

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

(2) "Manufacturing" means the activity of converting or conditioning 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.

(3) "Primarily" means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a).

(4) "Process" means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, 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 taxpayer's manufacturing, processing, refining, or recycling activity is conducted. Raw

materials that are stored on premises other than where the qualified taxpayer'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.

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

(6) "Qualified person" means either of the following:

(A) A person who is engaged in those lines of business described in Codes 3111 to 3399, inclusive, of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2007 edition.

(B) An affiliate of a person qualified pursuant to subparagraph (A) shall also be considered a qualified person as long as the affiliate is included as a member of that person's unitary group for which a combined report is required to be filed under Article 1 (commencing with Section 25101) of Chapter 17.

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

(i) Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures.

(ii) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, 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 taxpayer or another party.

(iii) Property used in pollution control that meets standards established by this state or any local or regional governmental agency within this state.

(iv) Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, or fabricating process, or that constitute a research or storage facility used during the manufacturing process. Buildings used solely for warehousing purposes after completion of the manufacturing process are not included.

(v) Fuels used or consumed in the manufacturing process.

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

(i) Consumables with a normal useful life of less than one year, except as provided in clause (v) of subparagraph (A).

(ii) Furniture, inventory, and equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing process.

(iii) Tangible personal property used primarily in administration, general management, or marketing.

(8) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(9) "Refining" means the process of converting a natural resource to an intermediate or finished product.

(c) An exemption shall not 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. The exemption certificate shall contain the sales price of the qualified tangible personal property that, the sale of, or the storage, use, or other consumption of, is exempt pursuant to subdivision (a).

(d) (1) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section shall not apply with respect to any tax levied by a county, city, or district pursuant to, or in accordance with, either of those laws.

(2) Notwithstanding subdivision (a), the exemption established by this section shall not apply with respect to any tax levied pursuant to Section 6051.2, 6051.5, 6201.2, or 6201.5, or pursuant to Section 35 of Article XIII of the California Constitution.

(e) Notwithstanding subdivision (a), the exemption provided by this section shall not apply to any sale or use of property which, 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 the exemption, or used in a manner not qualifying for the exemption.

(f) If a purchaser certifies in writing to the seller that the 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 within one year from the date of purchase, the purchaser (1) removes that property outside California, (2) converts that property for use in a manner not qualifying for the exemption, or (3) 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 property at the time the property is so removed, converted, or used, and the sales price of the property to the purchaser shall be deemed the gross receipts from that retail sale.

(g) This section applies to leases of tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Sections 6006.1 and 6010.1. The exemption established by this section shall apply to the rentals payable pursuant to such a lease, provided the lessee is a qualified person and the property is used in an activity described in subdivision (a). Rentals that meet the foregoing requirements are eligible for the exemption for a period of six years from the date of commencement of the lease. At the close of the six-year period from the date of commencement of the lease, lease receipts are subject to tax without exemption.

(h) The Legislative Analyst's Office shall complete and distribute a report to the Legislature on the effect of this exemption by January 1, 2019.

(i) This section shall cease to be operative on January 1, 2020, and shall be repealed on December 1, 2020.

SEC. 3. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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