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AMENDED IN ASSEMBLY MAY 12, 1999
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CALIFORNIA LEGISLATURE—1999–2000 REGULAR SESSION

ASSEMBLY BILL

No. 473

**Introduced by Assembly Member Hertzberg
(Principal coauthor: Assembly Member Florez)
(Coauthors: Assembly Members Alquist, Briggs, Calderon,
Cardenas, Cardoza, Cox, Cunneen, Dutra, Gallegos,
Jackson, Knox, Kuehl, Leach, Lempert, Longville,
Machado, Margett, Mazzoni, Reyes, Romero, Steinberg,
Washington, and Wright)
(Coauthors: Senators Baca, Costa, Figueroa, Johannessen,
Leslie, Lewis, McPherson, Rainey, Sher, and Solis)**

February 18, 1999

An act to amend Sections ~~17053.49~~ 6377, 17053.49, and 23649 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 473, as amended, Hertzberg. ~~Income~~ *Sales and use tax: income* and bank and corporation taxes: MIC.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property. That law provides various exemptions from that tax, including an exemption for tangible personal property purchased for

use by a qualified person, as defined, to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of property. Existing law provides that this exemption is repealed on January 1, 2001, or thereafter, as provided.

This bill would modify these repeal provisions to substitute 2004 for 2001.

The Personal Income Tax Law and the Bank and Corporation Tax Law allow to qualified taxpayers a credit against taxes imposed by those laws in an amount equal to 6% of the amount paid or incurred during the taxable or income year for qualified property that is placed in service in this state and, in general, includes specified types of tangible personal property used in connection with manufacturing activities. The credit is repealed as of January 1, 2001, or thereafter, as provided.

~~This bill would delete that repeal date, thereby continuing the credit indefinitely~~ *modify these repeal provisions to substitute 2004 for 2001.*

Counties and cities are authorized to impose local sales and use taxes in conformity with state sales and use taxes. Exemptions from state sales and use taxes enacted by the Legislature are incorporated into the local taxes.

Section 2230 of the Revenue and Taxation Code provides that the state will reimburse counties and cities for revenue losses caused by the enactment of sales and use tax exemptions.

This bill would provide that, notwithstanding Section 2230 of the Revenue and Taxation Code, no appropriation is made and the state shall not reimburse local agencies for sales and use tax revenues lost by them pursuant to this bill.

This bill would take effect immediately as a tax levy.

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

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

- 1 SECTION 1. *Section 6377 of the Revenue and*
- 2 *Taxation Code is amended to read:*



1 6377. (a) There are exempted from the taxes
2 imposed by this part the gross receipts from the sale of,
3 and the storage, use, or other consumption in this state of,
4 any of the following:

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

14 (2) Tangible personal property purchased for use by a
15 qualified person to be used primarily in research and
16 development.

17 (3) Tangible personal property purchased for use by a
18 qualified person to be used primarily to maintain, repair,
19 measure, or test any property described in paragraph (1)
20 or (2).

21 (4) Tangible personal property purchased for use by a
22 contractor purchasing that property either as an agent of
23 a qualified person or for the contractor's own account and
24 subsequent resale to a qualified person for use in the
25 performance of a construction contract for the qualified
26 person who will use the tangible personal property as an
27 integral part of the manufacturing, processing, refining,
28 fabricating, or recycling process, or as a research or
29 storage facility for use in connection with the
30 manufacturing process.

31 This exemption shall not apply to any tangible personal
32 property that is used primarily in administration, general
33 management, or marketing.

34 (b) For purposes of this section:

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

38 (2) "Manufacturing" means the activity of converting
39 or conditioning property by changing the form,
40 composition, quality, or character of the property for



1 ultimate sale at retail or use in the manufacturing of a
2 product to be ultimately sold at retail. Manufacturing
3 includes any improvements to tangible personal property
4 that result in a greater service life or greater functionality
5 than that of the original property.

6 (3) “Primarily” means tangible personal property
7 used 50 percent or more of the time in an activity
8 described in subdivision (a).

9 (4) “Process” means the period beginning at the point
10 at which any raw materials are received by the qualified
11 taxpayer and introduced into the manufacturing,
12 processing, refining, fabricating, or recycling activity of
13 the qualified taxpayer and ending at the point at which
14 the manufacturing, processing, refining, fabricating, or
15 recycling activity of the qualified taxpayer has altered
16 tangible personal property to its completed form,
17 including packaging, if required. Raw materials shall be
18 considered to have been introduced into the process
19 when the raw materials are stored on the same premises
20 where the qualified taxpayer’s manufacturing,
21 processing, refining, or recycling activity is conducted.
22 Raw materials that are stored on premises other than
23 where the qualified taxpayer’s manufacturing,
24 processing, refining, fabricating, or recycling activity is
25 conducted, shall not be considered to have been
26 introduced into the manufacturing, processing, refining,
27 fabricating, or recycling process.

28 (5) “Processing” means the physical application of the
29 materials and labor necessary to modify or change the
30 characteristics of property.

31 (6) “Qualified person” means any person that is both
32 of the following:

33 (A) A new trade or business. In determining whether
34 a trade or business activity qualifies as a new trade or
35 business, the following rules shall apply:

36 (i) In any case where a person purchases or otherwise
37 acquires all or any portion of the assets of an existing trade
38 or business (irrespective of the form of entity) that is
39 doing business in this state (within the meaning of Section
40 23101), the trade or business thereafter conducted by that



1 person (or any related person) shall not be treated as a
2 new business if the aggregate fair market value of the
3 acquired assets (including, real, personal, tangible, and
4 intangible property) used by that person (or any related
5 person) in the conduct of his or her trade or business
6 exceed 20 percent of the aggregate fair market value of
7 the total assets of the trade or business being conducted
8 by the person (or any related person). For purposes of
9 this subparagraph only, the following rules shall apply:

10 (I) The determination of the relative fair market
11 values of the acquired assets and the total assets shall be
12 made as of the last day of the month following the
13 quarterly period in which the person (or any related
14 person) first uses any of the acquired trade or business
15 assets in his or her business activity.

16 (II) Any acquired assets that constituted property
17 described in Section 1221(1) of the Internal Revenue
18 Code in the hands of the transferor shall not be treated as
19 assets acquired from an existing trade or business, unless
20 those assets also constitute property described in Section
21 1221(1) of the Internal Revenue Code in the hands of the
22 acquiring person (or related person).

23 (ii) In any case where a person (or any related person)
24 is engaged in one or more trade or business activities in
25 this state, or has been engaged in one or more trade or
26 business activities in this state within the preceding 36
27 months (“prior trade or business activity”), and
28 thereafter commences an additional trade or business
29 activity in this state, the additional trade or business
30 activity shall only be treated as a new business if the
31 additional trade or business activity is classified under a
32 different division of the Standard Industrial Classification
33 Manual published by the United States Office of
34 Management and Budget, 1987 edition, than are any of
35 the person’s (or any related person’s) current or prior
36 trade or business activities in this state.

37 (iii) In any case where a person, including all related
38 persons, is engaged in trade or business activities wholly
39 outside of this state and that person first commences
40 doing business in this state (within the meaning of Section



1 23101) after December 31, 1993 (other than by purchase
2 or other acquisition described in clause (i)), the trade or
3 business activity shall be treated as a new business.

4 (iv) In any case where the legal form under which a
5 trade or business activity is being conducted is changed,
6 the change in form shall be disregarded and the
7 determination of whether the trade or business activity
8 is a new business shall be made by treating the person as
9 having purchased or otherwise acquired all or any portion
10 of the assets of an existing trade or business under the
11 rules of clause (i).

12 (v) “Related person” means any person that is related
13 to that person under either Section 267 or 318 of the
14 Internal Revenue Code.

15 (vi) “Acquire” includes any gift, inheritance, transfer
16 incident to divorce, or any other transfer, whether or not
17 for consideration.

18 (B) Engaged in those lines of business described in
19 Codes 2011 to 3999, inclusive, of the Standard Industrial
20 Classification Manual published by the United States
21 Office of Management and Budget, 1987 edition.

22 (7) Notwithstanding paragraph (6), “qualified
23 person” shall not include any person who has conducted
24 business activities in a new trade or business for three or
25 more years.

26 (8) “Refining” means the process of converting a
27 natural resource to an intermediate or finished product.

28 (9) “Research and development” means those
29 activities that are described in Section 174 of the Internal
30 Revenue Code or in any regulations thereunder.

31 (10) “Tangible personal property” does not include
32 any of the following:

33 (A) Consumables with a normal useful life of less than
34 one year, except as provided in subparagraph (E) of
35 paragraph (10).

36 (B) Furniture, inventory, equipment used in the
37 extraction process, or equipment used to store finished
38 products that have completed the manufacturing
39 process.



1 (C) Any property for which a credit is claimed under
2 either Section 17053.49 or 23649.

3 (11) “Tangible personal property” includes, but is not
4 limited to, all of the following:

5 (A) Machinery and equipment, including component
6 parts and contrivances such as belts, shafts, moving parts,
7 and operating structures.

8 (B) All equipment or devices used or required to
9 operate, control, regulate, or maintain the machinery,
10 including, without limitation, computers, data processing
11 equipment, and computer software, together with all
12 repair and replacement parts with a useful life of one or
13 more years therefor, whether purchased separately or in
14 conjunction with a complete machine and regardless of
15 whether the machine or component parts are assembled
16 by the taxpayer or another party.

17 (C) Property used in pollution control that meets or
18 exceed standards established by this state or any local or
19 regional governmental agency within this state.

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

27 (E) Fuels used or consumed in the manufacturing
28 process.

29 (F) Property used in recycling.

30 (c) No exemption shall be allowed under this section
31 unless the purchaser furnishes the retailer with an
32 exemption certificate, completed in accordance with any
33 instructions or regulations as the board may prescribe,
34 and the retailer subsequently furnishes the board with a
35 copy of the exemption certificate. The exemption
36 certificate shall contain the sales price of the machinery
37 or equipment that is exempt pursuant to subdivision (a).

38 (d) Notwithstanding any provision of the
39 Bradley-Burns Uniform Local Sales and Use Tax Law
40 (Part 1.5 (commencing with Section 7200)) or the



1 Transactions and Use Tax Law (Part 1.6 (commencing
2 with Section 7251)), the exemption established by this
3 section shall not apply with respect to any tax levied by
4 a county, city, or district pursuant to, or in accordance
5 with, either of those laws.

6 (e) (1) Notwithstanding subdivision (a), the
7 exemption provided by this section shall not apply to any
8 sale or use of property which, within one year from the
9 date of purchase, is either removed from California or
10 converted from an exempt use under subdivision (a) to
11 some other use not qualifying for the exemption.

12 (2) Notwithstanding subdivision (a), on or after
13 January 1, 1995, the exemption established by this section
14 shall not apply with respect to any tax levied pursuant to
15 Sections 6051.2 and 6201.2, or pursuant to Section 35 of
16 Article XIII of the California Constitution.

17 (f) If a purchaser certifies in writing to the seller that
18 the property purchased without payment of the tax will
19 be used in a manner entitling the seller to regard the gross
20 receipts from the sale as exempt from the sales tax, and
21 within one year from the date of purchase, the purchaser
22 (1) removes that property outside California, (2)
23 converts that property for use in a manner not qualifying
24 for the exemption, or (3) uses that property in a manner
25 not qualifying for the exemption, the purchaser shall be
26 liable for payment of sales tax, with applicable interest, as
27 if the purchaser were a retailer making a retail sale of the
28 property at the time the property is so removed,
29 converted, or used, and the sales price of the property to
30 the purchaser shall be deemed the gross receipts from
31 that retail sale.

32 (g) (1) This section shall remain in effect until the
33 date specified in paragraph (2), on which date this section
34 shall cease to be operative, ~~and as of that date~~ and is
35 repealed.

36 (2) (A) This section shall cease to be operative on
37 January 1, ~~2001~~ 2004, or on January 1 of the earliest year
38 thereafter, if the total employment in this state *in the*
39 *preceding year*, as determined by the Employment
40 Development Department on the preceding January 1,



1 does not exceed by 100,000 jobs the total employment in
2 this state on January 1, 1994. The department shall report
3 annually to the Legislature with respect to the
4 determination required by the preceding sentence.

5 (B) For purposes of this paragraph, “total
6 employment” means the total employment in the
7 manufacturing sector, excluding employment in the
8 aerospace sector.

9 (h) This section applies to leases of tangible personal
10 property classified as “continuing sales” and “continuing
11 purchases” in accordance with Sections 6006.1 and 6010.1.
12 The exemption established by this section shall apply to
13 the rentals payable pursuant to such a lease, provided the
14 lessee is a qualified person and the property is used in an
15 activity described in subdivision (a). Rentals which meet
16 the foregoing requirements are eligible for the
17 exemption for a period of six years from the date of
18 commencement of the lease. At the close of the six-year
19 period from the date of commencement of the lease, lease
20 receipts are subject to tax without exemption.

21 *SEC. 2.* Section 17053.49 of the Revenue and Taxation
22 Code is amended to read:

23 17053.49. (a) (1) A qualified taxpayer shall be
24 allowed a credit against the “net tax,” as defined in
25 Section 17039, equal to 6 percent of the qualified cost of
26 qualified property that is placed in service in this state.

27 (2) In the case of any qualified costs paid or incurred
28 on or after January 1, 1994, and prior to the first taxable
29 year of the qualified taxpayer beginning on or after
30 January 1, 1995, the credit provided under paragraph (1)
31 shall be claimed by the qualified taxpayer on the qualified
32 taxpayer’s return for the first taxable year beginning on
33 or after January 1, 1995. No credit shall be claimed under
34 this section on a return filed for any taxable year
35 commencing prior to the qualified taxpayer’s first taxable
36 year beginning on or after January 1, 1995.

37 (b) (1) For purposes of this section, “qualified cost”
38 means any cost that satisfies each of the following
39 conditions:



1 (A) Except as otherwise provided in this
2 subparagraph, is a cost paid or incurred by the qualified
3 taxpayer for the construction, reconstruction, or
4 acquisition of qualified property on or after January 1,
5 1994, and prior to the date this section ceases to be
6 operative under paragraph (2) of subdivision (i). In the
7 case of any qualified property constructed,
8 reconstructed, or acquired by the qualified taxpayer (or
9 any person related to the qualified taxpayer within the
10 meaning of Section 267 or 707 of the Internal Revenue
11 Code) pursuant to a binding contract in existence on or
12 prior to January 1, 1994, costs paid pursuant to that
13 contract shall be subject to allocation as follows: contract
14 costs shall be allocated to qualified property based on a
15 ratio of costs actually paid prior to January 1, 1994, and
16 total contract costs actually paid. "Cost paid" shall
17 include, without limitation, contractual deposits and
18 option payments. To the extent of costs allocated,
19 whether or not currently deductible or depreciable for
20 tax purposes, to a period prior to January 1, 1994, the cost
21 shall be deemed allocated to property acquired before
22 January 1, 1994, and is thus not a "qualified cost."

23 (B) Except as provided in paragraph (3) of subdivision
24 (d) and subparagraph (B) of paragraph (4) of subdivision
25 (d), is an amount upon which the qualified taxpayer has
26 paid, directly or indirectly, as a separately stated contract
27 amount or as determined from the records of the
28 qualified taxpayer, sales or use tax under Part 1
29 (commencing with Section 6001).

30 (C) Is an amount properly chargeable to the capital
31 account of the qualified taxpayer.

32 (2) (A) For purposes of this subdivision, any contract
33 entered into on or after January 1, 1994, that is a successor
34 or replacement contract to a contract that was binding
35 prior to January 1, 1994, shall be treated as a binding
36 contract in existence prior to January 1, 1994.

37 (B) If a successor or replacement contract is entered
38 into on or after January 1, 1994, and the subject of the
39 successor or replacement contract relates both to
40 amounts for the construction, reconstruction, or



1 acquisition of qualified property described in the original
2 binding contract and to costs for the construction,
3 reconstruction, or acquisition of qualified property not
4 described in the original binding contract, then the
5 portion of those amounts described in the successor or
6 replacement contract that were not described in the
7 original binding contract shall not be treated as costs paid
8 or incurred pursuant to a binding contract in existence on
9 or prior to January 1, 1994, under subparagraph (A) of
10 paragraph (1).

11 (3) (A) For purposes of this section, an option
12 contract in existence prior to January 1, 1994, under which
13 a qualified taxpayer (or any other person related to the
14 qualified taxpayer within the meaning of Section 267 or
15 707 of the Internal Revenue Code) had an option to
16 acquire qualified property, shall be treated as a binding
17 contract under the rules in paragraph (2). For purposes
18 of this subparagraph, an option contract shall not include
19 an option under which the optionholder will forfeit an
20 amount less than 10 percent of the fixed option price in
21 the event the option is not exercised.

22 (B) For purposes of this section, a contract shall be
23 treated as binding even if the contract is subject to a
24 condition.

25 (4) For purposes of this subdivision, in the case of any
26 qualified taxpayer engaged in those lines of business
27 described in Codes 7371 to 7373, inclusive, of the Standard
28 Industrial Classification (SIC) Manual published by the
29 United States Office of Management and Budget, 1987
30 edition, “the first taxable year beginning on or after
31 January 1, 1998,” shall be substituted for “January 1, 1994,”
32 in each place in which it appears.

33 (c) (1) For purposes of this section, “qualified
34 taxpayer” means any taxpayer engaged in those lines of
35 business described in Codes 2011 to 3999, inclusive, or
36 Codes 7371 to 7373, inclusive, of the Standard Industrial
37 Classification (SIC) Manual published by the United
38 States Office of Management and Budget, 1987 edition.

39 (2) In the case of any pass-through entity, the
40 determination of whether a taxpayer is a qualified



1 taxpayer under this section shall be made at the entity
2 level and any credit under this section or Section 23649
3 shall be allowed to the pass-through entity and passed
4 through to the partners or shareholders in accordance
5 with applicable provisions of Part 10 (commencing with
6 Section 17001) or Part 11 (commencing with Section
7 23001). For purposes of this paragraph, the term
8 “pass-through entity” means any partnership or S
9 corporation.

10 (3) The Franchise Tax Board may prescribe
11 regulations to carry out the purposes of this section,
12 including any regulations necessary to prevent the
13 avoidance of the effect of this section through splitups,
14 shell corporations, partnerships, tiered ownership
15 structures, sale-leaseback transactions, or otherwise.

16 (d) For purposes of this section, “qualified property”
17 means property that is described as any of the following:

18 (1) Tangible personal property that is defined in
19 Section 1245(a) of the Internal Revenue Code for use by
20 a qualified taxpayer in those lines of business described in
21 Codes 2011 to 3999, inclusive, of the Standard Industrial
22 Classification (SIC) Manual published by the United
23 States Office of Management and Budget, 1987 edition,
24 that is primarily used for any of the following:

25 (A) For the manufacturing, processing, refining,
26 fabricating, or recycling of property, beginning at the
27 point at which any raw materials are received by the
28 qualified taxpayer and introduced into the process and
29 ending at the point at which the manufacturing,
30 processing, refining, fabricating, or recycling has altered
31 tangible personal property to its completed form,
32 including packaging, if required.

33 (B) In research and development.

34 (C) To maintain, repair, measure, or test any property
35 described in this paragraph.

36 (D) For pollution control that meets or exceeds
37 standards established by the state or by any local or
38 regional governmental agency within the state.

39 (E) For recycling.



1 (2) Computers and computer peripheral equipment,
2 as defined in Section 168(i)(2)(B) of the Internal
3 Revenue Code, that is tangible personal property as
4 defined in Section 1245(a) of the Internal Revenue Code
5 for use by a qualified taxpayer in those lines of business
6 described in SIC Codes 7371 to 7373, inclusive, of the SIC
7 Manual, 1987 edition, that is primarily used to develop or
8 manufacture prepackaged software or custom software
9 prepared to the special order of the purchaser who uses
10 the program to produce and sell or license copies of the
11 program as prepackaged software.

12 (3) The value of any capitalized labor costs that are
13 directly allocable to the construction or modification of
14 property described in paragraph (1) or (2).

15 (4) In the case of any qualified taxpayer engaged in
16 manufacturing activities described in SIC Code 357 or
17 367, those activities related to biotechnology described in
18 SIC Code 8731, those activities related to
19 biopharmaceutical establishments only that are
20 described in SIC Codes 2833 to 2836, inclusive, those
21 activities related to space vehicles and parts described in
22 SIC Codes 3761 to 3769, inclusive, those activities related
23 to space satellites and communications satellites and
24 equipment described in SIC Codes 3663 and 3812 (but
25 only with respect to “qualified property” that is placed in
26 service on or after January 1, 1996), or those activities
27 related to semiconductor equipment manufacturing
28 described in SIC Code 3559 (but only with respect to
29 “qualified property” that is placed in service on or after
30 January 1, 1997), “qualified property” also includes the
31 following:

32 (A) Special purpose buildings and foundations that are
33 constructed or modified for use by the qualified taxpayer
34 primarily in a manufacturing, processing, refining, or
35 fabricating process, or as a research or storage facility
36 primarily used in connection with a manufacturing
37 process.

38 (B) The value of any capitalized labor costs that are
39 directly allocable to the construction or modification of
40 special purpose buildings and foundations that are used



1 primarily in the manufacturing, processing, refining, or
2 fabricating process, or as a research or storage facility
3 primarily used in connection with a manufacturing
4 process.

5 (C) (i) For purposes of this paragraph, “special
6 purpose building and foundation” means only a building
7 and the foundation immediately underlying the building
8 that is specifically designed and constructed or
9 reconstructed for the installation, operation, and use of
10 specific machinery and equipment with a special
11 purpose, which machinery and equipment, after
12 installation, will become affixed to or a fixture of the real
13 property, and the construction or reconstruction of which
14 is specifically designed and used exclusively for the
15 specified purposes as set forth in subparagraph (A)
16 (“qualified purpose”).

17 (ii) A building is specifically designed and constructed
18 or modified for a qualified purpose if it is not economical
19 to design and construct the building for the intended
20 purpose and then use the structure for a different
21 purpose.

22 (iii) For purposes of clause (i) and clause (vi), a
23 building is used exclusively for a qualified purpose only if
24 its use does not include a use for which it was not
25 specifically designed and constructed or modified.
26 Incidental use of a building for nonqualified purposes
27 does not preclude the building from being a special
28 purpose building. “Incidental use” means a use which is
29 both related and subordinate to the qualified purpose. It
30 will be conclusively presumed that a use is not
31 subordinate if more than one-third of the total usable
32 volume of the building is devoted to a use which is not a
33 qualified purpose.

34 (iv) In the event an entire building does not qualify as
35 a special purpose building, a taxpayer may establish that
36 a portion of a building, and the foundation immediately
37 underlying the portion, qualifies for treatment as a special
38 purpose building and foundation if the portion satisfies all
39 of the definitional provisions in this subparagraph.



1 (v) To the extent that a building is not a special
2 purpose building as defined above, but a portion of the
3 building qualifies for treatment as a special purpose
4 building, then all equipment which exclusively supports
5 the qualified purpose occurring within that portion and
6 which would qualify as Internal Revenue Code Section
7 1245 property if it were not a fixture or affixed to the
8 building shall be treated as a cost of the portion of the
9 building which qualifies for treatment as a special
10 purpose building.

11 (vi) Buildings and foundations which do not meet the
12 definition of a special purpose building and foundation set
13 forth above include, but are not limited to: buildings
14 designed and constructed or reconstructed principally to
15 function as a general purpose manufacturing, industrial,
16 or commercial building; research facilities that are used
17 primarily prior to or after, or prior to and after, the
18 manufacturing process; or storage facilities that are used
19 primarily prior to or after, or prior to and after,
20 completion of the manufacturing process. A research
21 facility shall not be considered to be used primarily prior
22 to or after, or prior to and after, the manufacturing
23 process if its purpose and use relate exclusively to the
24 development and regulatory approval of the
25 manufacturing process for specific biopharmaceutical
26 products. A research facility which is used primarily in
27 connection with the discovery of an organism from which
28 a biopharmaceutical product or process is developed does
29 not meet the requirements of the preceding sentence.

30 (5) Subject to the provisions in subparagraph (B) of
31 paragraph (1) of subdivision (b), qualified property also
32 includes computer software that is primarily used for
33 those purposes set forth in paragraph (1) or (2) of this
34 subdivision.

35 (6) Qualified property does not include any of the
36 following:

37 (A) Furniture.

38 (B) Facilities used for warehousing purposes after
39 completion of the manufacturing process.

40 (C) Inventory.

1 (D) Equipment used in the extraction process.

2 (E) Equipment used to store finished products that
3 have completed the manufacturing process.

4 (F) Any tangible personal property that is used in
5 administration, general management, or marketing.

6 (G) Any vehicle for which a credit is claimed pursuant
7 to Section 17052.11 or 23603.

8 (e) For purposes of this section:

9 (1) “Biopharmaceutical activities” means those
10 activities that use organisms or materials derived from
11 organisms, and their cellular, subcellular, or molecular
12 components, in order to provide pharmaceutical
13 products for human or animal therapeutics and
14 diagnostics. Biopharmaceutical activities make use of
15 living organisms to make commercial products, as
16 opposed to pharmaceutical activities which make use of
17 chemical compounds to produce commercial products.

18 (2) “Fabricating” means to make, build, create,
19 produce, or assemble components or property to work in
20 a new or different manner.

21 (3) “Manufacturing” means the activity of converting
22 or conditioning property by changing the form,
23 composition, quality, or character of the property for
24 ultimate sale at retail or use in the manufacturing of a
25 product to be ultimately sold at retail. Manufacturing
26 includes any improvements to tangible personal property
27 that result in a greater service life or greater functionality
28 than that of the original property.

29 (4) “Other biotechnology activities” means activities
30 consisting of the application of recombinant DNA
31 technology to produce commercial products, as well as
32 activities regarding pharmaceutical delivery systems
33 designed to provide a measure of control over the rate,
34 duration, and site of pharmaceutical delivery.

35 (5) “Primarily” means tangible personal property
36 used 50 percent or more of the time in an activity
37 described in subdivision (d).

38 (6) “Process” means the period beginning at the point
39 at which any raw materials are received by the qualified
40 taxpayer and introduced into the manufacturing,



1 processing, refining, fabricating, or recycling activity of
2 the qualified taxpayer and ending at the point at which
3 the manufacturing, processing, refining, fabricating, or
4 recycling activity of the qualified taxpayer has altered
5 tangible personal property to its completed form,
6 including packaging, if required. Raw materials shall be
7 considered to have been introduced into the process
8 when the raw materials are stored on the same premises
9 where the qualified taxpayer's manufacturing,
10 processing, refining, or recycling activity is conducted.
11 Raw materials that are stored on premises other than
12 where the qualified taxpayer's manufacturing,
13 processing, refining, fabricating, or recycling activity is
14 conducted, shall not be considered to have been
15 introduced into the manufacturing, processing, refining,
16 fabricating, or recycling process.

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

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

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

25 (10) "Small business" means a qualified taxpayer that
26 meets any of the following requirements during the
27 taxable year for which the credit is allowed:

28 (A) Has gross receipts of less than fifty million dollars
29 (\$50,000,000).

30 (B) Has net assets of less than fifty million dollars
31 (\$50,000,000).

32 (C) Has a total credit of less than one million dollars
33 (\$1,000,000).

34 (D) For taxable years beginning on or after January 1,
35 1997, is engaged in biopharmaceutical activities or other
36 biotechnology activities that are described in Codes 2833
37 to 2836, inclusive, of the Standard Industrial Classification
38 (SIC) Manual published by the United States Office of
39 Management and Budget, 1987 edition, and has not

1 received regulatory approval for any product from the
2 United States Food and Drug Administration.

3 (f) The credit allowed under subdivision (a) shall
4 apply to qualified property that is acquired by or subject
5 to lease by a qualified taxpayer, subject to the following
6 special rules:

7 (1) A lessor of qualified property, irrespective of
8 whether the lessor is a qualified taxpayer, shall not be
9 allowed the credit provided under subdivision (a) with
10 respect to any qualified property leased to another
11 qualified taxpayer.

12 (2) For purposes of paragraphs (2) and (3) of
13 subdivision (b), “binding contract” shall include any
14 lease agreement with respect to the qualified property.

15 (3) (A) For purposes of determining the qualified
16 cost paid or incurred by a lessee in any leasing transaction
17 that is not treated as a sale under Part 1 (commencing
18 with Section 6001), the following rules shall apply:

19 (i) Except as provided by subparagraph (C) of this
20 paragraph, subparagraphs (A) and (C) of paragraph (1)
21 of subdivision (b) shall not apply.

22 (ii) Except as provided in subparagraph (B) and
23 clause (iii), the “qualified cost” upon which the lessee
24 shall compute the credit provided under this section shall
25 be equal to the original cost to the lessor (within the
26 meaning of Section 18031) of the qualified property that
27 is the subject of the lease.

28 (iii) Except as provided in clause (iv), the
29 requirement of subparagraph (B) of paragraph (1) of
30 subdivision (b) shall be treated as satisfied only if the
31 lessor has made a timely election under either Section
32 6094.1 or subdivision (d) of Section 6244 and has paid sales
33 tax reimbursement or use tax measured by the purchase
34 price of the qualified property (within the meaning of
35 paragraph (5) of subdivision (g) of Section 6006). For
36 purposes of this subdivision and clause (iv), the amount
37 of original cost to the lessor which may be taken into
38 account under clause (ii) shall not exceed the purchase
39 price upon which sales tax reimbursement or use tax has



1 been paid under the preceding sentence or under clause
2 (iv).

3 (iv) With respect to leases entered into between
4 January 1, 1994, and the effective date of this clause, the
5 lessor may elect to pay use tax measured by the purchase
6 price of the property by reporting and paying the tax with
7 the return of the lessor for the fourth calendar quarter of
8 1994. In computing the use tax under the preceding
9 sentence, a credit shall be allowed under Part 1
10 (commencing with Section 6001) for all sales or use tax
11 previously paid on the lease.

12 (B) For purposes of applying subparagraph (A) only,
13 the following special rules shall apply:

14 (i) The original cost to the lessor of the qualified
15 property shall be reduced by the amount of any original
16 cost of that property that was taken into account by any
17 predecessor lessee in computing the credit allowable
18 under this section.

19 (ii) Clause (i) shall not apply in any case where the
20 predecessor lessee was required to recapture the credit
21 provided under this section pursuant to subdivision (g).

22 (iii) For purposes of this section only, in any case
23 where a successor lessor has acquired qualified property
24 from a predecessor lessor in a transaction not treated as
25 a sale under Part 1 (commencing with Section 6001), the
26 original cost to the successor lessor of the qualified
27 property shall be reduced by the amount of the original
28 cost of the qualified property that was taken into account
29 by any lessee of the predecessor lessor in computing the
30 credit allowable under this section.

31 (C) In determining the original cost of any qualified
32 property under this paragraph, only amounts paid or
33 incurred by the lessor on or after January 1, 1994, and
34 prior to the date this section ceases to be operative under
35 paragraph (2) of subdivision (i), shall be taken into
36 account. In the case of any qualified property
37 constructed, reconstructed, or acquired by a lessor
38 pursuant to a binding contract in existence on or prior to
39 January 1, 1994, the allocation rule specified in
40 subparagraph (A) of paragraph (1) of subdivision (b)



1 shall apply in determining the original cost to the lessor
2 of qualified property.

3 (D) Notwithstanding subparagraph (A), in the case of
4 any leasing transaction for which the lessee is allowed the
5 credit under this section and thereafter the lessee (or any
6 party related to the lessee within the meaning of Section
7 267 or 318 of the Internal Revenue Code) acquires the
8 qualified property from the lessor (or any successor
9 lessor) within one year from the date the qualified
10 property is first used by the lessee under the terms of the
11 lease, the lessee's (or related party's) acquisition of the
12 qualified property from the lessor (or successor lessor)
13 shall be treated as a disposition by the lessee of the
14 qualified property that was subject to the lease under
15 subdivision (g).

16 (4) For purposes of determining the qualified cost
17 paid or incurred by a lessee in any leasing transaction that
18 is treated as a sale under Part 1 (commencing with
19 Section 6001), the following rules shall apply:

20 (A) Subparagraph (A) of paragraph (1) of subdivision
21 (b) shall be applied by substituting the term "purchase"
22 for the term "construction, reconstruction, or
23 acquisition."

24 (B) Subparagraph (C) of paragraph (1) of subdivision
25 (b) shall apply.

26 (C) The requirement of subparagraph (B) of
27 paragraph (1) of subdivision (b) shall be treated as
28 satisfied at the time that either the lessor or the qualified
29 taxpayer pays sales or use tax under Part 1 (commencing
30 with Section 6001).

31 (5) (A) In the case of any leasing transaction
32 described in paragraph (3), the lessor shall provide a
33 statement to the lessee specifying the amount of the
34 lessor's original cost of the qualified property and the
35 amount of that cost upon which a sales or use tax was paid
36 within 45 days after the close of the lessee's taxable year
37 in which the credit is allowable to the lessee under this
38 section.



1 (B) The statement required under subparagraph (A)
2 shall be provided to the Franchise Tax Board upon
3 request.

4 (6) For purposes of this subdivision, in the case of any
5 qualified taxpayer engaged in those lines of business
6 described in Codes 7371 to 7373, inclusive, of the Standard
7 Industrial Classification (SIC) Manual published by the
8 United States Office of Management and Budget, 1987
9 edition, “the first taxable year beginning on or after
10 January 1, 1998,” shall be substituted for “January 1, 1994,”
11 in each place in which it appears. In addition, “the
12 effective date of this paragraph” shall be substituted for
13 “the effective date of this clause” and “fourth calendar
14 quarter of 1998” shall be substituted for “fourth calendar
15 quarter of 1994.”

16 (g) No credit shall be allowed if the qualified property
17 is removed from the state, is disposed of to an unrelated
18 party, or is used for any purpose not qualifying for the
19 credit provided in this section in the same taxable year in
20 which the qualified property is first placed in service in
21 this state. If any qualified property for which a credit is
22 allowed pursuant to this section is thereafter removed
23 from this state, disposed of to an unrelated party, or used
24 for any purpose not qualifying for the credit provided in
25 this section within one year from the date the qualified
26 property is first placed in service in this state, the amount
27 of the credit allowed by this section for that qualified
28 property shall be recaptured by adding that credit
29 amount to the net tax of the qualified taxpayer for the
30 taxable year in which the qualified property is disposed
31 of, removed, or put to an ineligible use.

32 (h) In the case where the credit allowed by this section
33 exceeds the “net tax,” the excess may be carried over to
34 reduce the “net tax” in the following year, and
35 succeeding years as follows:

36 (1) Except as provided in paragraph (2), for the seven
37 succeeding years if necessary, until the credit is
38 exhausted.



1 (2) In the case of a small business, for the nine
2 succeeding years, if necessary, until the credit is
3 exhausted.

4 (i) (1) *This section shall remain in effect until the*
5 *date specified in paragraph (2), on which date the section*
6 *shall cease to be operative and is repealed.*

7 (2) (A) *This section shall cease to be operative on*
8 *January 1, 2004, or on January 1 of the earliest year*
9 *thereafter, if the total employment in this state in the*
10 *preceding year, as determined by the Employment*
11 *Development Department on the preceding January 1,*
12 *does not exceed by 100,000 jobs the total employment in*
13 *this state on January 1, 1994. The department shall report*
14 *to the Legislature annually with respect to the*
15 *determination required by the preceding sentence.*

16 (B) *For purposes of this paragraph, “total*
17 *employment” means the total employment in the*
18 *manufacturing sector, excluding employment in the*
19 *aerospace sector.*

20 (j) The amendments made by the act adding this
21 subdivision shall be operative for taxable years beginning
22 on or after January 1, 1997, except as provided in
23 paragraph (3) of subdivision (d).

24 ~~(j)~~

25 (k) The amendments made by the act adding this
26 subdivision shall be operative for taxable years beginning
27 on or after January 1, 1998.

28 ~~SEC. 2.—~~

29 *SEC. 3.* Section 23649 of the Revenue and Taxation
30 Code is amended to read:

31 23649. (a) (1) A qualified taxpayer shall be allowed
32 a credit against the “tax,” as defined in Section 23036,
33 equal to 6 percent of the qualified cost of qualified
34 property that is placed in service in this state.

35 (2) In the case of any qualified costs paid or incurred
36 on or after January 1, 1994, and prior to the first income
37 year of the qualified taxpayer beginning on or after
38 January 1, 1995, the credit provided under paragraph (1)
39 shall be claimed by the qualified taxpayer on the qualified
40 taxpayer’s return for the first income year beginning on



1 or after January 1, 1995. No credit shall be claimed under
2 this section on a return filed for any income year
3 commencing prior to the qualified taxpayer's first income
4 year beginning on or after January 1, 1995.

5 (b) (1) For purposes of this section, "qualified cost"
6 means any cost that satisfies each of the following
7 conditions:

8 (A) Except as otherwise provided in this
9 subparagraph, is a cost paid or incurred by the qualified
10 taxpayer for the construction, reconstruction, or
11 acquisition of qualified property on or after January 1,
12 1994, and prior to the date this section ceases to be
13 operative under paragraph (2) of subdivision (i). In the
14 case of any qualified property constructed,
15 reconstructed, or acquired by the qualified taxpayer (or
16 any person related to the qualified taxpayer within the
17 meaning of Section 267 or 707 of the Internal Revenue
18 Code) pursuant to a binding contract in existence on or
19 prior to January 1, 1994, costs paid pursuant to that
20 contract shall be subject to allocation as follows: contract
21 costs shall be allocated to qualified property based on a
22 ratio of costs actually paid prior to January 1, 1994, and
23 total contract costs actually paid. "Cost paid" shall
24 include, without limitation, contractual deposits and
25 option payments. To the extent of cost allocated, whether
26 or not currently deductible or depreciable for tax
27 purposes, to a period prior to January 1, 1994, the cost shall
28 be deemed allocated to property acquired before January
29 1, 1994, and is thus not a "qualified cost."

30 (B) Except as provided in paragraph (3) of subdivision
31 (d) and subparagraph (B) of paragraph (4) of subdivision
32 (d), is an amount upon which the qualified taxpayer has
33 paid, directly or indirectly as a separately stated contract
34 amount or as determined from the records of the
35 qualified taxpayer, sales or use tax under Part 1
36 (commencing with Section 6001).

37 (C) Is an amount properly chargeable to the capital
38 account of the qualified taxpayer.

39 (2) (A) For purposes of this subdivision, any contract
40 entered into on or after January 1, 1994, that is a successor



1 or replacement contract to a contract that was binding
2 prior to January 1, 1994, shall be treated as a binding
3 contract in existence prior to January 1, 1994.

4 (B) If a successor or replacement contract is entered
5 into on or after January 1, 1994, and the subject of the
6 successor or replacement contract relates both to
7 amounts for the construction, reconstruction, or
8 acquisition of qualified property described in the original
9 binding contract and to costs for the construction,
10 reconstruction, or acquisition of qualified property not
11 described in the original binding contract, then the
12 portion of those amounts described in the successor or
13 replacement contract that were not described in the
14 original binding contract shall not be treated as costs paid
15 or incurred pursuant to a binding contract in existence on
16 or prior to January 1, 1994, under subparagraph (A) of
17 paragraph (1).

18 (3) (A) For purposes of this section, an option
19 contract in existence prior to January 1, 1994, under which
20 a qualified taxpayer (or any other person related to the
21 qualified taxpayer within the meaning of Section 267 or
22 707 of the Internal Revenue Code) had an option to
23 acquire qualified property, shall be treated as a binding
24 contract under the rules in paragraph (2). For purposes
25 of this subparagraph, an option contract shall not include
26 an option under which the optionholder will forfeit an
27 amount less than 10 percent of the fixed option price in
28 the event the option is not exercised.

29 (B) For purposes of this section, a contract shall be
30 treated as binding even if the contract is subject to a
31 condition.

32 (4) For purposes of this subdivision, in the case of any
33 qualified taxpayer engaged in those lines of business
34 described in Codes 7371 to 7373, inclusive, of the Standard
35 Industrial Classification (SIC) Manual published by the
36 United States Office of Management and Budget, 1987
37 edition, “the first income year beginning on or after
38 January 1, 1998,” shall be substituted for “January 1, 1994,”
39 in each place in which it appears.



1 (c) (1) For purposes of this section, “qualified
2 taxpayer” means any taxpayer engaged in those lines of
3 business described in Codes 2011 to 3999, inclusive, or
4 Codes 7371 to 7373, inclusive, of the Standard Industrial
5 Classification (SIC) Manual published by the United
6 States Office of Management and Budget, 1987 edition.

7 (2) In the case of any pass-through entity, the
8 determination of whether a taxpayer is a qualified
9 taxpayer shall be made at the entity level and any credit
10 under this section or Section 17053.49 shall be allowed to
11 the pass-through entity and passed through to the
12 partners or shareholders in accordance with applicable
13 provisions of Part 10 (commencing with Section 17001) or
14 Part 11 (commencing with Section 23001). For purposes
15 of this paragraph, the term “pass-through entity” means
16 any partnership or S corporation.

17 (3) The Franchise Tax Board may prescribe
18 regulations to carry out the purposes of this section,
19 including any regulations necessary to prevent the
20 avoidance of the effect of this section through splitups,
21 shell corporations, partnerships, tiered ownership
22 structures, sale-leaseback transactions, or otherwise.

23 (d) For purposes of this section, “qualified property”
24 means property that is described as either of the
25 following:

26 (1) Tangible personal property that is defined in
27 Section 1245(a) of the Internal Revenue Code for use by
28 a qualified taxpayer in those lines of business described in
29 Codes 2011 to 3999, inclusive, of the Standard Industrial
30 Classification (SIC) Manual published by the United
31 States Office of Management and Budget, 1987 edition,
32 that is primarily used for any of the following:

33 (A) For the manufacturing, processing, refining,
34 fabricating, or recycling of property, beginning at the
35 point at which any raw materials are received by the
36 qualified taxpayer and introduced into the process and
37 ending at the point at which the manufacturing,
38 processing, refining, fabricating, or recycling has altered
39 tangible personal property to its completed form,
40 including packaging, if required.



1 (B) In research and development.

2 (C) To maintain, repair, measure, or test any property
3 described in this paragraph.

4 (D) For pollution control that meets or exceeds
5 standards established by the state or by any local or
6 regional governmental agency within the state.

7 (E) For recycling.

8 (2) Computers and computer peripheral equipment,
9 as defined in Section 168(i)(2)(B) of the Internal
10 Revenue Code, that is tangible personal property as
11 defined in Section 1245(a) of the Internal Revenue Code
12 for use by a qualified taxpayer in those lines of business
13 described in SIC Codes 7371 to 7373, inclusive, of the SIC
14 Manual, 1987 edition, that is primarily used to develop or
15 manufacture prepackaged software or custom software
16 prepared to the special order of the purchaser who uses
17 the program to produce and sell or license copies of the
18 program as prepackaged software.

19 (3) The value of any capitalized labor costs that are
20 directly allocable to the construction or modification of
21 property described in paragraph (1) or (2).

22 (4) In the case of any qualified taxpayer engaged in
23 manufacturing activities described in SIC Code 357 or
24 367, those activities related to biotechnology described in
25 SIC Code 8731, those activities related to
26 biopharmaceutical establishments only that are
27 described in SIC Codes 2833 to 2836, inclusive, those
28 activities related to space vehicles and parts described in
29 SIC Codes 3761 to 3769, inclusive, those activities related
30 to space satellites and communications satellites and
31 equipment described in SIC Codes 3663 and 3812 (but
32 only with respect to “qualified property” that is placed in
33 service on or after January 1, 1996), or those activities
34 related to semiconductor equipment manufacturing
35 described in SIC Code 3559 (but only with respect to
36 “qualified property” that is placed in service on or after
37 January 1, 1997), “qualified property” also includes the
38 following:

39 (A) Special purpose buildings and foundations that are
40 constructed or modified for use by the qualified taxpayer



1 primarily in a manufacturing, processing, refining, or
2 fabricating process, or as a research or storage facility
3 primarily used in connection with a manufacturing
4 process.

5 (B) The value of any capitalized labor costs that are
6 directly allocable to the construction or modification of
7 special purpose buildings and foundations that are used
8 primarily in the manufacturing, processing, refining, or
9 fabricating process, or as a research or storage facility
10 primarily used in connection with a manufacturing
11 process.

12 (C) (i) For purposes of this paragraph, “special
13 purpose building and foundation” means only a building
14 and the foundation immediately underlying the building
15 that is specifically designed and constructed or
16 reconstructed for the installation, operation, and use of
17 specific machinery and equipment with a special
18 purpose, which machinery and equipment, after
19 installation, will become affixed to or a fixture of the real
20 property, and the construction or reconstruction of which
21 is specifically designed and used exclusively for the
22 specified purposes as set forth in subparagraph (A)
23 (“qualified purpose”).

24 (ii) A building is specifically designed and constructed
25 or modified for a qualified purpose if it is not economical
26 to design and construct the building for the intended
27 purpose and then use the structure for a different
28 purpose.

29 (iii) For purposes of clause (i) and clause (vi), a
30 building is used exclusively for a qualified purpose only if
31 its use does not include a use for which it was not
32 specifically designed and constructed or modified.
33 Incidental use of a building for nonqualified purposes
34 does not preclude the building from being a special
35 purpose building. “Incidental use” means a use which is
36 both related and subordinate to the qualified purpose. It
37 will be conclusively presumed that a use is not
38 subordinate if more than one-third of the total usable
39 volume of the building is devoted to a use which is not a
40 qualified purpose.



1 (iv) In the event an entire building does not qualify as
2 a special purpose building, a taxpayer may establish that
3 a portion of a building, and the foundation immediately
4 underlying the portion, qualifies for treatment as a special
5 purpose building and foundation if the portion satisfies all
6 of the definitional provisions in this subparagraph.

7 (v) To the extent that a building is not a special
8 purpose building as defined above, but a portion of the
9 building qualifies for treatment as a special purpose
10 building, then all equipment which exclusively supports
11 the qualified purpose occurring within that portion and
12 which would qualify as Internal Revenue Code Section
13 1245 property if it were not a fixture or affixed to the
14 building shall be treated as a cost of the portion of the
15 building which qualifies for treatment as a special
16 purpose building.

17 (vi) Buildings and foundations which do not meet the
18 definition of a special purpose building and foundation set
19 forth above include, but are not limited to: buildings
20 designed and constructed or reconstructed principally to
21 function as a general purpose manufacturing, industrial,
22 or commercial building; research facilities that are used
23 primarily prior to or after, or prior to and after, the
24 manufacturing process; or storage facilities that are used
25 primarily prior to or after, or prior to and after,
26 completion of the manufacturing process. A research
27 facility shall not be considered to be used primarily prior
28 to or after, or prior to and after, the manufacturing
29 process if its purpose and use relate exclusively to the
30 development and regulatory approval of the
31 manufacturing process for specific biopharmaceutical
32 products. A research facility which is used primarily in
33 connection with the discovery of an organism from which
34 a biopharmaceutical product or process is developed does
35 not meet the requirements of the preceding sentence.

36 (5) Subject to the provisions in subparagraph (B) of
37 paragraph (1) of subdivision (b), qualified property also
38 includes computer software that is primarily used for
39 those purposes set forth in paragraph (1) or (2) of this
40 subdivision.



1 (6) Qualified property does not include any of the
2 following:

3 (A) Furniture.

4 (B) Facilities used for warehousing purposes after
5 completion of the manufacturing process.

6 (C) Inventory.

7 (D) Equipment used in the extraction process.

8 (E) Equipment used to store finished products that
9 have completed the manufacturing process.

10 (F) Any tangible personal property that is used in
11 administration, general management, or marketing.

12 (G) Any vehicle for which a credit is claimed pursuant
13 to Section 17052.11 or 23603.

14 (e) For purposes of this section:

15 (1) “Biopharmaceutical activities” means those
16 activities that use organisms or materials derived from
17 organisms, and their cellular, subcellular, or molecular
18 components, in order to provide pharmaceutical
19 products for human or animal therapeutics and
20 diagnostics. Biopharmaceutical activities make use of
21 living organisms to make commercial products, as
22 opposed to pharmaceutical activities which make use of
23 chemical compounds to produce commercial products.

24 (2) “Fabricating” means to make, build, create,
25 produce, or assemble components or property to work in
26 a new or different manner.

27 (3) “Manufacturing” means the activity of converting
28 or conditioning property by changing the form,
29 composition, quality, or character of the property for
30 ultimate sale at retail or use in the manufacturing of a
31 product to be ultimately sold at retail. Manufacturing
32 includes any improvements to tangible personal property
33 that result in a greater service life or greater functionality
34 than that of the original property.

35 (4) “Other biotechnology activities” means activities
36 consisting of the application of recombinant DNA
37 technology to produce commercial products, as well as
38 activities regarding pharmaceutical delivery systems
39 designed to provide a measure of control over the rate,
40 duration, and site of pharmaceutical delivery.



1 (5) “Primarily” means tangible personal property
2 used 50 percent or more of the time in an activity
3 described in subdivision (d).

4 (6) “Process” means the period beginning at the point
5 at which any raw materials are received by the qualified
6 taxpayer and introduced into the manufacturing,
7 processing, refining, fabricating, or recycling activity of
8 the qualified person and ending at the point at which the
9 manufacturing, processing, refining, fabricating, or
10 recycling activity of the qualified taxpayer has altered
11 tangible personal property to its completed form,
12 including packaging, if required. Raw materials shall be
13 considered to have been introduced into the process
14 when the raw materials are stored on the same premises
15 where the qualified taxpayer’s manufacturing,
16 processing, refining, fabricating, or recycling activity is
17 conducted. Raw materials that are stored on premises
18 other than where the qualified taxpayer’s manufacturing,
19 processing, refining, fabricating, or recycling activity is
20 conducted, shall not be considered to have been
21 introduced into the manufacturing, processing, refining,
22 fabricating, or recycling process.

23 (7) “Processing” means the physical application of the
24 materials and labor necessary to modify or change the
25 characteristics of property.

26 (8) “Refining” means the process of converting a
27 natural resource to an intermediate or finished product.

28 (9) “Research and development” means those
29 activities that are described in Section 174 of the Internal
30 Revenue Code or in any regulations thereunder.

31 (10) “Small business” means a qualified taxpayer that
32 meets any of the following requirements during the
33 income year for which the credit is allowed:

34 (A) Has gross receipts of less than fifty million dollars
35 (\$50,000,000).

36 (B) Has net assets of less than fifty million dollars
37 (\$50,000,000).

38 (C) Has a total credit of less than one million dollars
39 (\$1,000,000).



1 (D) For income years beginning on or after January 1,
2 1997, is engaged in biopharmaceutical activities or other
3 biotechnology activities that are described in Codes 2833
4 to 2836, inclusive, of the Standard Industrial Classification
5 (SIC) Manual published by the United States Office of
6 Management and Budget, 1987 edition, and has not
7 received regulatory approval for any product from the
8 United States Food and Drug Administration.

9 (f) The credit allowed under subdivision (a) shall
10 apply to qualified property that is acquired by or subject
11 to lease by a qualified taxpayer, subject to the following
12 special rules:

13 (1) A lessor of qualified property, irrespective of
14 whether the lessor is a qualified taxpayer, shall not be
15 allowed the credit provided under subdivision (a) with
16 respect to any qualified property leased to another
17 qualified taxpayer.

18 (2) For purposes of paragraphs (2) and (3) of
19 subdivision (b), “binding contract” shall include any
20 lease agreement with respect to the qualified property.

21 (3) (A) For purposes of determining the qualified
22 cost paid or incurred by a lessee in any leasing transaction
23 that is not treated as a sale under Part 1 (commencing
24 with Section 6001), the following rules shall apply:

25 (i) Except as provided by subparagraph (C) of this
26 paragraph, subparagraphs (A) and (C) of paragraph (1)
27 of subdivision (b) shall not apply.

28 (ii) Except as provided in subparagraph (B) and
29 clause (iii), the “qualified cost” upon which the lessee
30 shall compute the credit provided under this section shall
31 be equal to the original cost to the lessor (within the
32 meaning of Section 24912) of the qualified property that
33 is the subject of the lease.

34 (iii) Except as provided in clause (iv), the
35 requirement of subparagraph (B) of paragraph (1) of
36 subdivision (b) shall be treated as satisfied only if the
37 lessor has made a timely election under either Section
38 6094.1 or subdivision (d) of Section 6244 and has paid sales
39 tax reimbursement or use tax measured by the purchase
40 price of the qualified property (within the meaning of



1 paragraph (5) of subdivision (g) of Section 6006). For
2 purposes of this subdivision and clause (iv), the amount
3 of original cost to the lessor which may be taken into
4 account under clause (ii) shall not exceed the purchase
5 price upon which sales tax reimbursement or use tax has
6 been paid under the preceding sentence or under clause
7 (iv).

8 (iv) With respect to leases entered into between
9 January 1, 1994, and the effective date of this clause, the
10 lessor may elect to pay use tax measured by the purchase
11 price of the property by reporting and paying the tax with
12 the return of the lessor for the fourth calendar quarter of
13 1994. In computing the use tax under the preceding
14 sentence, a credit shall be allowed under Part 1
15 (commencing with Section 6001) for all sales or use tax
16 previously paid on the lease.

17 (B) For purposes of applying subparagraph (A) only,
18 the following special rules shall apply:

19 (i) The original cost to the lessor of the qualified
20 property shall be reduced by the amount of any original
21 cost of that property that was taken into account by any
22 predecessor lessee in computing the credit allowable
23 under this section.

24 (ii) Clause (i) shall not apply in any case where the
25 predecessor lessee was required to recapture the credit
26 provided under this section pursuant to subdivision (g).

27 (iii) For purposes of this section only, in any case
28 where a successor lessor has acquired qualified property
29 from a predecessor lessor in a transaction not treated as
30 a sale under Part 1 (commencing with Section 6001), the
31 original cost to the successor lessor of the qualified
32 property shall be reduced by the amount of the original
33 cost of the qualified property that was taken into account
34 by any lessee of the predecessor lessor in computing the
35 credit allowable under this section.

36 (C) In determining the original cost of any qualified
37 property under this paragraph, only amounts paid or
38 incurred by the lessor on or after January 1, 1994, and
39 prior to the date this section ceases to be operative under
40 paragraph (2) of subdivision (i), shall be taken into



1 account. In the case of any qualified property
2 constructed, reconstructed, or acquired by a lessor
3 pursuant to a binding contract in existence on or prior to
4 January 1, 1994, the allocation rule specified in
5 subparagraph (A) of paragraph (1) of subdivision (b)
6 shall apply in determining the original cost to the lessor
7 of qualified property.

8 (D) Notwithstanding subparagraph (A), in the case of
9 any leasing transaction for which the lessee is allowed the
10 credit under this section and thereafter the lessee (or any
11 party related to the lessee within the meaning of Section
12 267 or 318 of the Internal Revenue Code) acquires the
13 qualified property from the lessor (or any successor
14 lessor) within one year from the date the qualified
15 property is first used by the lessee under the terms of the
16 lease, the lessee's (or related party's) acquisition of the
17 qualified property from the lessor (or successor lessor)
18 shall be treated as a disposition by the lessee of the
19 qualified property that was subject to the lease under
20 subdivision (g).

21 (4) For purposes of determining the qualified cost
22 paid or incurred by a lessee in any leasing transaction that
23 is treated as a sale under Part 1 (commencing with
24 Section 6001), the following rules shall apply:

25 (A) Subparagraph (A) of paragraph (1) of subdivision
26 (b) shall be applied by substituting the term "purchase"
27 for the term "construction, reconstruction, or
28 acquisition."

29 (B) Subparagraph (C) of paragraph (1) of subdivision
30 (b) shall apply.

31 (C) The requirement of subparagraph (B) of
32 paragraph (1) of subdivision (b) shall be treated as
33 satisfied at the time that either the lessor or the qualified
34 taxpayer pays sales or use tax under Part 1 (commencing
35 with Section 6001).

36 (5) (A) In the case of any leasing transaction
37 described in paragraph (3), the lessor shall provide a
38 statement to the lessee specifying the amount of the
39 lessor's original cost of the qualified property and the
40 amount of that cost upon which a sales or use tax was paid



1 within 45 days after the close of the lessee's taxable year
2 in which the credit is allowable to the lessee under this
3 section.

4 (B) The statement required under subparagraph (A)
5 shall be provided to the Franchise Tax Board upon
6 request.

7 (6) For purposes of this subdivision, in the case of any
8 qualified taxpayer engaged in those lines of business
9 described in Codes 7371 to 7373, inclusive, of the Standard
10 Industrial Classification (SIC) Manual published by the
11 United States Office of Management and Budget, 1987
12 edition, "the first income year beginning on or after
13 January 1, 1998," shall be substituted for "January 1, 1994,"
14 in each place in which it appears. In addition, "the
15 effective date of this paragraph" shall be substituted for
16 "the effective date of this clause" and "fourth calendar
17 quarter of 1998" shall be substituted for "fourth calendar
18 quarter of 1994."

19 (g) No credit shall be allowed if the qualified property
20 is removed from the state, is disposed of to an unrelated
21 party, or is used for any purpose not qualifying for the
22 credit provided in this section in the same taxable year in
23 which the qualified property is first placed in service in
24 this state. If any qualified property for which a credit is
25 allowed pursuant to this section is thereafter removed
26 from this state, disposed of to an unrelated party, or used
27 for any purpose not qualifying for the credit provided in
28 this section within one year from the date the qualified
29 property is first placed in service in this state, the amount
30 of the credit allowed by this section for that qualified
31 property shall be recaptured by adding that credit
32 amount to the net tax of the qualified taxpayer for the
33 taxable year in which the qualified property is disposed
34 of, removed, or put to an ineligible use.

35 (h) In the case where the credit allowed by this section
36 exceeds the "tax," the excess may be carried over to
37 reduce the "tax" in the following year, and succeeding
38 years as follows:



1 (1) Except as provided in paragraph (2), for the seven
2 succeeding years if necessary, until the credit is
3 exhausted.

4 (2) In the case of a small business, for the nine
5 succeeding years, if necessary, until the credit is
6 exhausted.

7 (i) *(1) This section shall remain in effect until the*
8 *date specified in paragraph (2), on which date the section*
9 *shall cease to be operative and is repealed.*

10 (2) (A) *This section shall cease to be operative on*
11 *January 1, 2004, or on January 1 of the earliest year*
12 *thereafter, if the total employment in this state in the*
13 *preceding year, as determined by the Employment*
14 *Development Department on the preceding January 1,*
15 *does not exceed by 100,000 jobs the total employment in*
16 *this state on January 1, 1994. The department shall report*
17 *to the Legislature annually with respect to the*
18 *determination required by the preceding sentence.*

19 (B) *For purposes of this paragraph, "total*
20 *employment" means the total employment in the*
21 *manufacturing sector, excluding employment in the*
22 *aerospace sector. The amendments made by Chapter 954*
23 *of the Statutes of 1996 shall be operative for income years*
24 *beginning on or after January 1, 1997, except as provided*
25 *in paragraph (3) of subdivision (d).*

26 ~~(j)~~

27 (k) The amendments made by Chapter 323 of the
28 Statutes of 1998 shall be operative for income years
29 beginning on or after January 1, 1998.

30 ~~SEC. 3.—~~

31 *SEC. 4. Notwithstanding Section 2230 of the Revenue*
32 *and Taxation Code, no appropriation is made by this act*
33 *and the state shall not reimburse any local agency for any*
34 *sales and use tax revenues lost by it under this act.*

35 *SEC. 5. This act provides for a tax levy within the*
36 *meaning of Article IV of the Constitution and shall go into*
37 *immediate effect.*

