AMENDED IN ASSEMBLY APRIL 1, 2014

CALIFORNIA LEGISLATURE—2013–14 REGULAR SESSION

# ASSEMBLY BILL No. 1997

**Introduced by Assembly Member Gorell**

February 20, 2014

~~An act relating to unmanned aircraft systems.~~ *An act to amend Section 6377.1 of, and to add and repeal Sections 17053.83 and 23623.3 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.*

LEGISLATIVE COUNSEL'S DIGEST

AB 1997, as amended, Gorell. ~~Unmanned aircraft systems.~~ *Sales and use taxes: exemptions: unmanned aerial vehicle manufacturing: income taxes: credits: hiring.*

*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, and provides various exemptions from the taxes imposed by that law.*

*Existing law includes an exemption from those taxes, on and after July 1, 2014, and before January 1, 2022, for the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property purchased by a qualified person, including persons engaged in aircraft manufacturing, for use primarily in manufacturing, processing, refining, fabricating, or recycling of property, or research and development, and qualified tangible personal property purchased for use by a contractor for specified purposes, as provided. Existing law specifies 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 Education Protection Account, the Local Revenue Fund, the Fiscal Recovery Fund, or the Local Revenue Fund 2011.*

*This bill, on and after January 1, 2015, would instead provide that the exemption also applies to local sales and use taxes and those specified state taxes with respect to qualified tangible personal property purchased by a qualified person that is engaged in aircraft manufacturing of unmanned aerial vehicles.*

*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. Amendments to state sales and use taxes are incorporated into these laws.*

*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 any local agencies for sales and use tax revenues lost by them pursuant to this bill.*

*The Personal Income Tax Law and the Corporation Tax Law allow various credits against the taxes imposed by those laws.*

*This bill would allow, under both laws, for taxable years beginning on or after January 1, 2015, and before January 1, 2025, a credit in an amount equal to a specified percentage of the qualified wages, as defined, paid or incurred by a qualified taxpayer that manufactures unmanned aerial vehicles with respect to qualified employees, as defined, during the taxable year, not to exceed $20,000 per year, per qualified employee.*

*This bill would take effect immediately as a tax levy.*

~~Existing federal law, the Federal Aviation Administration Modernization and Reform Act of 2012, provides for the integration of civil unmanned aircraft systems, commonly known as drones, into the national airspace system by September 30, 2015. Existing federal law requires the Administrator of the Federal Aviation Administration to develop and implement operational and certification requirements for~~

~~the operation of public unmanned aircraft systems in the national airspace system by December 31, 2015.~~

~~This bill would state the intent of the Legislature to enact legislation that would provide incentives to unmanned aircraft system manufacturers that manufacture those systems in this state, in order to capture and develop the incredible future growth of the unmanned aircraft system manufacturing industry within California. The bill would also define "unmanned aircraft system" for those purposes.~~

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

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

*SECTION 1. Section 6377.1 of the Revenue and Taxation Code is amended to read:*

6377.1. (a) Except as provided in subdivision (e), on or after July 1, 2014, and before July 1, 2022, 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 tangible personal 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 tangible personal property to its completed form, including packaging, if required.

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

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

(4) 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, that will use that property as an integral part of the manufacturing, processing,

refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

(b) For purposes of this section:

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

(2) “Manufacturing” means the activity of converting or conditioning tangible personal 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 50 percent or more of the time.

(4) “Process” means the period beginning at the point at which any raw materials are received by the qualified person and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person 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 person’s manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person’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 tangible personal property.

(6) (A) “Qualified person” means a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, inclusive, 541711, or 541712 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.

(B) Notwithstanding subparagraph (A), “qualified person” shall not include either of the following:

(i) An apportioning trade or business that is required to apportion its business income pursuant to subdivision (b) of Section 25128.

(ii) A trade or business conducted wholly within this state that would be required to apportion its business income pursuant to subdivision (b) of Section 25128 if it were subject to apportionment pursuant to Section 25101.

(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) Equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, but not limited to, 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 qualified person or another party.

(iii) Tangible personal 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, fabricating, or recycling process, or that constitute a research or storage facility used during those processes. Buildings used solely for warehousing purposes after completion of those processes are not included.

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

(i) Consumables with a useful life of less than one year.

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

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

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

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

(10) “Useful life” for tangible personal property that is treated as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this section. “Useful life” for tangible personal property that is treated as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this section.

(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 retains the exemption certificate in its records and furnishes it to the board upon request.

(d) (1) *(A)* Notwithstanding the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) and 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)~~

*(B)* 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, pursuant to Section 35 of Article XIII of the California Constitution, or any tax levied pursuant to Section 6051 or 6201 that is deposited in the State Treasury to the credit of the Local Revenue Fund 2011 pursuant to Section 6051.15 or 6201.15.

*(2) On and after January 1, 2015, paragraph (1) shall not apply to qualified tangible personal property purchased for use by a qualified person primarily engaged in the line of business described in Industry Group 336411 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, that manufactures unmanned aerial vehicles.*

(e) (1) The exemption provided by this section shall not apply to either of the following:

(A) Any tangible personal property purchased during any calendar year that exceeds two hundred million dollars ($200,000,000) of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person under this section. For purposes of this subparagraph, in the case of a qualified person that is required to be included in a combined report under Section 25101 or authorized to be included in a combined report under Section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this section by all persons that are required or authorized to be included in a combined report shall not exceed two hundred million dollars ($200,000,000) in any calendar year.

(B) The sale or storage, use, or other consumption of property that, 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 exemption, or used in a manner not qualifying for exemption.

(2) If a purchaser certifies in writing to the seller that the tangible personal 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 the purchase exceeds the two-hundred-million-dollar ($200,000,000) limitation described in subparagraph (A) of paragraph (1), or within one year from the date of purchase, the purchaser removes that property from California, converts that property for use in a manner not qualifying for the exemption, or 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 tangible personal property at the time the tangible personal property is so purchased, removed, converted, or used, and the cost of the tangible personal property to the purchaser shall be deemed the gross receipts from that retail sale.

(f) This section shall apply to leases of qualified 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 the lease, provided the lessee is a qualified person and the tangible personal property is used in an activity described in subdivision (a).

(g) (1) Upon the effective date of this section, the Department of Finance shall estimate the total dollar amount of exemptions that will be taken for each calendar year, or any portion thereof, for which this section provides an exemption.

(2) No later than each March 1 next following a calendar year for which this section provides an exemption, the board shall provide to the Joint Legislative Budget Committee a report of the total dollar amount of exemptions taken under this section for the immediately preceding calendar year. The report shall compare the total dollar amount of exemptions taken under this section for that calendar year with the department's estimate for that same calendar year. If that total dollar amount taken is less than the estimate for that calendar year, the report shall identify options for increasing exemptions taken so as to meet estimated amounts.

(h) This section is repealed on January 1, 2023.

*SEC. 2. Section 17053.83 is added to the Revenue and Taxation Code, to read:*

*17053.83. (a) For each taxable year beginning on or after January 1, 2015, and before January 1, 2025, there shall be allowed as a credit against the "net tax," as defined in Section 17039, to a qualified taxpayer who employs a qualified employee during the taxable year in an amount equal to the following:*

*(1) Fifty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2015, and before January 1, 2017.*

*(2) Forty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2017, and before January 1, 2019.*

*(3) Thirty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2019, and before January 1, 2021.*

*(4) Twenty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2021, and before January 1, 2023.*

*(5) Ten percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2023, and before January 1, 2025.*

*(b) For purposes of this section:*

*(1) "Qualified taxpayer" means any taxpayer that is primarily engaged in the line of business described in Industry Group 336411*

*of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, that manufactures unmanned aerial vehicles.*

*(2) "Qualified employee" means an individual who is hired by the qualified taxpayer during the taxable year, whose services for the qualified taxpayer are performed in this state and are at least 90 percent directly related to the qualified taxpayer's line of business described in Industry Group 336411 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, manufacturing unmanned aerial vehicles.*

*(3) "Qualified wages" means that portion of wages paid or incurred by the qualified taxpayer during the taxable year with respect to qualified employees that are direct costs, as defined in Section 263A of the Internal Revenue Code, allocable to property manufactured in this state by the qualified taxpayer.*

*(c) The credit allowed by this section shall not exceed twenty thousand dollars ($20,000) per year, per qualified employee. For employees who are qualified employees for part of a taxable year, the credit shall not exceed twenty thousand dollars ($20,000) multiplied by a fraction, the numerator of which is the number of months of the taxable year that the employee is a qualified employee and the denominator of which is 12.*

*(d) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and seven succeeding years if necessary, until the credit is exhausted.*

*(e) The credit allowed by this section shall be in lieu of any other credit or deduction that the qualified taxpayer may otherwise be allowed pursuant to this part.*

*(f) The Franchise Tax Board may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this section.*

*(g) This section shall remain in effect only until December 1, 2025, and as of that date is repealed.*

*SEC. 3. Section 23623.3 is added to the Revenue and Taxation Code, to read:*

*23623.3. (a) For each taxable year beginning on or after January 1, 2015, and before January 1, 2025, there shall be allowed as a credit against "tax," as defined in Section 23036, to* *a qualified taxpayer who employs a qualified employee during the taxable year in an amount equal to the following:*

*(1) Fifty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2015, and before January 1, 2017.*

*(2) Forty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2017, and before January 1, 2019.*

*(3) Thirty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2019, and before January 1, 2021.*

*(4) Twenty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2021, and before January 1, 2023.*

*(5) Ten percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2023, and before January 1, 2025.*

*(b) For purposes of this section:*

*(1) "Qualified taxpayer" means any taxpayer that is primarily engaged in the line of business described in Industry Group 336411 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, that manufactures unmanned aerial vehicles.*

*(2) "Qualified employee" means an individual who is hired by the qualified taxpayer during the taxable year, whose services for the qualified taxpayer are performed in this state and are at least 90 percent directly related to the qualified taxpayer's line of business described in Industry Group 336411 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, manufacturing unmanned aerial vehicles.*

*(3) "Qualified wages" means that portion of wages paid or incurred by the qualified taxpayer during the taxable year with respect to qualified employees that are direct costs, as defined in Section 263A of the Internal Revenue Code, allocable to property manufactured in this state by the qualified taxpayer.*

*(c) The credit allowed by this section shall not exceed twenty thousand dollars ($20,000) per year, per qualified employee. For employees who are qualified employees for part of a taxable year, the credit shall not exceed twenty thousand dollars ($20,000)*

*multiplied by a fraction, the numerator of which is the number of months of the taxable year that the employee is a qualified employee and the denominator of which is 12.*

*(d) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and seven succeeding years if necessary, until the credit is exhausted.*

*(e) The credit allowed by this section shall be in lieu of any other credit or deduction that the qualified taxpayer may otherwise be allowed pursuant to this part.*

*(f) The Franchise Tax Board may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this section.*

*(g) This section shall remain in effect only until December 1, 2025, and as of that date is repealed.*

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

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

~~SECTION 1. It is the intent of the Legislature to enact legislation that would provide incentives to unmanned aircraft system manufacturers that manufacture those systems in this state, in order to capture and develop the incredible future growth of the unmanned aircraft system manufacturing industry within California. "Unmanned aircraft system" means an unmanned aircraft and associated elements, including communication links and the components that control the unmanned aircraft, that are required for the pilot in command to operate safely and efficiently in the national airspace system.~~

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