



STATE BOARD OF EQUALIZATION

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July 15, 1999

Mr. A--- N. L---
The O--- Company
P.O. Box XXX
---, New Jersey XXXXX

Re: SR -- XX-XXXXXX
Revenue and Taxation Code section 6902.2

Dear Mr. L---:

This is in response to your June 17, 1999 letter. You ask whether your company may claim a refund of its Manufacturer's Investment Credit pursuant to Revenue and Taxation Code section 6902.2¹ under certain circumstances.

You state:

"The O--- Company, Inc. [(hereafter "O---")] is a manufacturer of electric cable and is a 'qualified taxpayer' who purchases 'qualified property' for the Manufacturer's Investment Credit (MIC). As of January 1, 1998 our Company elected to become an 'S' Corporation for Federal and State of California income tax purposes. As a California 'S' Corporation, our Company's taxable income is subject to a lower tax rate of 1.5%. We are also limited to use only one-third of the total of any available tax credits against this liability. The remaining two-thirds must be disregarded and may not be carried over by the 'S' Corporation."

You ask a series of questions based on the above facts. For purposes of clarity, we have separately responded to each of your questions below.

¹ All further references are to the Revenue and Taxation Code unless otherwise noted.

“My first question is that since we are not allowed to use two-thirds of the ‘MIC’ against the Company’s tax liability, can we apply for a refund of sales tax paid (in accordance with RTC Sec. 6902.2) on the qualified manufacturing equipment equal to the income tax credit amount the Company could have claimed if it were allowed to and what forms are used to claim this refund and where can we obtain them?”

By way of background, section 6902.2 authorizes taxpayers to file for a refund in lieu of taking the manufacturer’s investment credit (“MIC”) in an amount that would otherwise be allowed pursuant to the MIC. To do so, a taxpayer must submit a claim for refund no earlier than the date a claim could have been made for a tax credit or carryover of the MIC. The amount of the refund may not exceed the amount of credit that the taxpayer could have used to offset personal income or bank or corporation tax liability. That is, the taxpayer may not obtain a refund in excess of the amount that it could have claimed as a credit against an existing tax liability on its personal income, bank, or corporation tax return. A claim for refund must be accompanied by a copy of an invoice or purchase contract for each item purchased that qualified for the MIC which indicates: a) the date on which the purchase occurred, b) a description of the property purchased, c) the price paid for the property, and d) the amount of tax paid with respect to the purchase. (See § 6902.2(a)(1) - (a)(3).) The person seeking the refund must also provide a copy of the personal, bank, or corporation tax return on which the tax liability was assessed (for which the in-lieu refund is being claimed under section 6902.2),² and should provide a copy of its form 3535. No interest is paid on amounts refunded pursuant to section 6902.2. (§ 6902.2(b).)

Section 6902.2 is unusual in that it involves the application of provisions from both the California Sales and Use Tax Law and the California Franchise and Income Tax Law. I am only able to comment on those portions of section 6902.2 involving the Sales and Use Tax Law. My comments, if any, regarding the MIC or other provisions of the Franchise or Income Tax Law are not binding on this Agency or on the Franchise Tax Board (“FTB”). You may wish to contact Mr. Scott Ewing at the FTB ((916) 845-3323) regarding any questions you have regarding the MIC.

² Taxpayers filing on a unitary basis must also provide evidence that the particular entity of the unitary group claiming the refund is also the same entity that incurred the tax liability and the MIC. The members of a unitary group may not aggregate the total amount of MIC and tax liability for a section 6902.2 claim for refund. Instead, each individual member of the unitary group must be considered separately such that the amount of MIC generated by that member (and claimed in a section 6902.2 claim for refund) may not exceed the amount of tax liability similarly generated by that same member.

I agree that a California S-Corporation is subject to an income tax rate of 1.5 percent. The income or loss of an S-Corporation is distributed among the shareholders of the corporation pursuant to a schedule K-1. This income (or loss) is taxed at the income tax rate applicable to each particular shareholder of the S-Corporation.

When an S-Corporation claims the MIC (and has a tax liability that may be offset by the MIC), I agree that the FTB allows 33 percent of the MIC to apply against the S-Corporation's tax liability. I understand, however, that the full amount of the MIC (i.e., 100 percent of the MIC) is **also** passed through from the S-Corporation to each of the shareholders on a pro-rata basis measured by the shareholder's interest in the S-Corporation. That is, the S-Corporation gets the benefit of one-third of the MIC while the shareholders also receive 100 percent of the MIC on a pro-rata basis. The full amount of the MIC passed on to a shareholder may be applied against any existing tax liability of that shareholder. If the shareholder has no tax liability, that shareholder may not apply the MIC.

The 66 percent of MIC not available to the S-Corporation is not subject to a refund. The rationale for this result is twofold. First, section 6902.2 only authorizes a refund for an amount that would otherwise be allowed pursuant to the MIC (and which can be set off by an existing tax liability). The FTB only allows an S-Corporation to claim 33 percent of the MIC. Since the total amount of an S-Corporation's MIC is subject to the 33 percent limitation, the total amount of refund allowed pursuant to section 6902.2 is also subject to that limitation. Second, a refund of the 66 percent amount would result in a windfall to the S-Corporation. Again, the FTB allows an S-Corporation to claim 33 percent of the MIC while similarly allowing its shareholders to claim 100 percent of the MIC on a pro-rata basis. The net result is that the S-Corporation and its shareholder may potentially claim 133 percent of the MIC. Allowing the S-Corporation to also claim a refund of the 66 percent would then increase the potential MIC benefit to 200 percent. That would be a benefit well beyond the parameters currently authorized by the FTB.

You should also note that a different result occurs if the S-Corporation claims a refund of 33 percent of its MIC. When this occurs, the MIC is then eliminated and the credit cannot be passed on to, and claimed by, the shareholders of the S-Corporation. This is because the MIC is determined by the activity of the entity. If the S-Corporation chooses to take the refund, this refund is in lieu of the MIC and the MIC cannot then be passed on to the shareholders. This rationale equally applies to claims for refund made pursuant to section 6902.2 by the shareholders of an S-Corporation. That is, shareholders of an S-Corporation may not claim a section 6902.2 refund where the S-Corporation claims the MIC and then "passes through" the MIC to its shareholders. Section 6902.2 only authorizes a refund to "a person that has paid sales tax reimbursement to a retailer or use tax on a purchase ... of property for which a [MIC] credit may be allowed...." Where an S-Corporation (and not the shareholders) purchases and pays tax on tangible personal property, the section 6902.2 refund is only available to the S-Corporation and not the shareholders since the shareholders would not have paid tax on the S-Corporation's purchases. If the S-Corporation took the MIC, the shareholders can take the MIC. If the S-Corporation took the refund, there is no MIC to pass through to the shareholders since the refund to the S-Corporation was in lieu of the MIC.

“Second, if we decide to waive the income tax credit in lieu of the sales tax refund in one tax year, can we take the tax credit on the next tax year on different equipment or is waiving the income tax credit irrevocable for all future years?”

Section 6902.2 only authorizes a refund for an amount not exceeding the amount of credit that could have need used to offset personal income or bank or corporation tax liability. An S-Corporation is further limited to claiming only 33 percent of the MIC. Any claim for refund filed by your company in excess of these amounts would be denied and will not be subject to refund in later periods. Any earned but unclaimed MIC from a section 6902.2 claim for refund may be carried forward for future years subject to the MIC carry-forward rules administered by the FTB.

“Finally, if we know that our Company will not be using the ‘MIC’, must we still pay or self-assess tax during the year and then apply for a refund of those taxes (not including the county and district taxes) or can we just pay and assess the applicable county and district taxes and not assess the state tax which [on] we would be claiming a refund?”

To claim a section 6902.2 refund, your company **must** pay California tax or tax reimbursement at the time of its acquisition of qualified property. Your company may then file a claim for refund no earlier than the date a claim could have been made for a tax credit or carryover of the MIC. Your company may not claim a section 6902.2 refund by only paying California tax or tax reimbursement measured by the difference between the full tax amount less the MIC. Only a pre-qualified, “new trade or business” as defined in section 6377 is partially exempt from tax or tax reimbursement imposed on the gross receipts or sales price from the sale or purchase of qualified property at the time of the sale or purchase. You should contact Ms. Nini McCormack ((916) 324-2921) to obtain the necessary information if you believe you qualify for the section 6377 partial exemption.

I trust this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Senior Tax Counsel

WLA:cl

cc: Ms. Nini McCormack (MIC:40)
Out-of-State District Administrator (OH)