



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

January 31, 2014

Dear Interested Party:

Enclosed is the Third Discussion Paper on proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*. Before the issue is presented at the Board's April 22, 2014 Business Taxes Committee meeting, staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, a third interested parties meeting is scheduled as follows:

February 18, 2014
Room 122 at 10:00 a.m.
450 N Street, Sacramento, CA

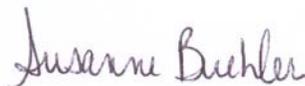
If you would like to participate by teleconference, call 1-888-636-3807 and enter access code 499201. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at Susanne.Buehler@boe.ca.gov by February 28, 2014. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

If proposed Regulation 1525.4 is determined to be a major regulation under the provisions of Senate Bill 617 (Chapter 496, Statutes of 2011), this interested parties meeting will provide an opportunity for public input regarding alternatives to the regulation. Please see the California Department of Finance webpage for information about the provisions of SB 617 (http://www.dof.ca.gov/research/economic_research_unit/SB617_regulation/view.php).

If you are interested in other Business Taxes Committee topics refer to our webpage (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of discussion or issue papers, minutes, a procedures manual, and calendars arranged according to subject matter and by month.

Thank you for your consideration. We look forward to your comments and suggestions. Should you have any questions, please feel free to contact our Business Taxes Committee staff member Ms. Lynn Whitaker at Lynn.Whitaker@boe.ca.gov or 1-916-324-8483, who will be leading the meeting.

Sincerely,



Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB: lw

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC:71)
Senator George Runner (Ret.), Member, Second District (via email)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. David Hunter, Board Member's Office, Fourth District
Ms. Jaclyn Appleby, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichel, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Yvette Stowers, Board Member's Office, First District
Mr. Ramon Salazar, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Ms. Lynne Kinst, Board Member's Office, Second District
Ms. Tanya Vandrick, Board Member's Office, Second District
Mr. Alan Giorgi, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges (MIC:73)
Mr. Randy Ferris (MIC:83)
Mr. Jeffrey L. McGuire (MIC:43)
Mr. Jeff Vest (MIC:85)
Mr. Jeff Angeja (MIC:85)
Mr. David Levine (MIC:85)
Mr. Robert Tucker (MIC:82)
Mr. Bradley Heller (MIC:82)

Mr. Andrew Kwee (MIC:82)
Mr. Lawrence Mendel (MIC:82)
Mr. Todd Gilman (MIC:70)
Ms. Laureen Simpson (MIC:70)
Mr. Bill Benson (MIC:67)
Mr. Joe Fitz (MIC:67)
Mr. Wayne Mashihara (MIC:46)
Mr. Kevin Hanks (MIC:49)
Mr. Bradley Miller (MIC:92)
Ms. Kirsten Stark (MIC:50)
Mr. Clifford Oakes (MIC:50)
Ms. Lynn Whitaker (MIC:50)
Mr. Michael Patno (MIC:50)
Ms. Trista Gonzalez (MIC:44)
Mr. Jason Parker (MIC:44)
Ms. Tracy McCrite (MIC:44)
Mr. Robert Prasad (MIC: 44)

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Proposed Regulation 1525.4, *Manufacturing and*
Research & Development Equipment

I. Issue

Whether the Board should approve proposed Sales and Use Tax Regulation 1525.4, *Manufacturing and Research & Development Equipment*, to implement and explain the new partial exemption from sales and use tax for sales and purchases of manufacturing, research and development equipment that was established by Revenue and Taxation Code (RTC) section 6377.1.

II. Staff Recommendation

Staff recommends revisions to proposed Regulation 1525.4 to clarify three main issues:

- The definition of “qualified person” based on establishments within an entity rather than the entity itself,
- The determination of whether a person is primarily engaged in a qualifying line of business based on revenue or expenses of the establishment, and
- How the partial exemption applies to construction contracts for special purpose buildings and foundations.

Additional revisions are proposed to address several other issues as noted on pages 6-7. See Exhibit 1 for staff’s proposed Regulation 1525.4.

III. Other Alternative(s) Considered

Submissions regarding areas of concern and general revision suggestions were received from the California Manufacturers & Technology Association (CMTA); the California Taxpayers Association (CalTax); Mr. Jesse McClellan from McClellan Davis, LLC; and Mr. Lawrence Duncan, from Lockheed Martin Corporation (Lockheed). (See Exhibits 2, 3, 4, and 5 for copies of submissions.) Comments from these interested parties are discussed in the following sections.

IV. Background

Created by Assembly Bill 93 (AB 93) (Stats. 2013, Ch. 69), as amended by Senate Bill 90 (SB 90) (Stats. 2013, Ch. 70) RTC section 6377.1 provides a partial exemption from sales and use tax on certain manufacturing, research and development equipment sales and purchases. The partial exemption applies to qualifying sales and purchases made on or after July 1, 2014, and before July 1, 2022.

The current statewide sales and use tax rate is 7.50%, although the combined tax rate is higher in cities and counties that impose additional district taxes. RTC section 6377.1 exempts certain transactions from the state general fund taxes imposed by RTC sections 6051¹, 6051.3, 6201²,

¹ Except for the taxes deposited pursuant to RTC section 6051.15.

² Except for the taxes deposited pursuant to RTC section 6201.15.

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and 6201.3 and the State's Education Protection Account tax imposed by Section 36, Article XIII of the State Constitution. Accordingly, from July 1, 2014, to December 31, 2016, the partial exemption will be 4.1875%. After the Education Protection Account tax expires on December 31, 2016, the partial exemption will be 3.9375% from January 1, 2017, to June 30, 2022.

If the Education Protection Account tax is extended, or there is any other tax rate change in the RTC sections covered by the exemption, staff will amend any references to the partial exemption rate in Regulation 1525.4 accordingly. Changes of this type are generally processed as Rule 100 revisions³. In addition to updating the regulation, whenever there is a change in the tax rate, the Board of Equalization (BOE) notifies affected taxpayers of the change including any effect on partial exemptions.

It is not required that equipment purchased under the partial exemption be used in a former enterprise zone or other designated area. Although this was a requirement in AB 93, the language of RTC section 6377.1 provided in SB 90 replaced the AB 93 language and the restriction was removed. Property purchased under the partial exemption may be used anywhere in California.

Prior partial exemption for manufacturing equipment

RTC section 6377.1 is substantially modeled from the prior partial exemption for manufacturing equipment provided by RTC section 6377 and interpreted in Regulation 1525.2, *Manufacturing Equipment*. Under the prior program, from January 1, 1994 to December 31, 2003, new manufacturers could qualify for a partial exemption from sales and use tax on purchases of certain manufacturing equipment. The law also provided manufacturers income tax credits of 6% for similar equipment placed in service in California. The partial exemption and credit related to equipment used primarily for manufacturing, refining, processing, fabricating, or recycling. New manufacturers could claim the partial sales and use tax exemption or the Manufacturers' Investment Credit (MIC). However, existing manufacturers could only claim the MIC.

V. Discussion

This paper discusses issues that were brought up at the second meeting with interested parties on December 5, 2013 and in the submissions received following that meeting.

³ California Code of Regulations, Title 1, Section 100 allows an agency to add to, revise or delete regulatory text without the regular rulemaking procedures when the revision is a "change without regulatory effect." These changes include making regulatory provisions consistent with a changed California statute when the regulatory provision is inconsistent with and superseded by the changed statute, and the adopting agency has no discretion to adopt a change which differs in substance from the one chosen. Revisions to make the partial exemption rate consistent with a changed statute would fall into this category.

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BOE interpretation of RTC section 6377.1

In their submission, CMTA urged staff to draft the regulation to reflect a broad and liberal interpretation of the authorizing statute. They explained that narrow interpretations and overly-complicated compliance requirements could put a damper on manufacturers' willingness to take advantage of the exemption. They believe that this approach will increase manufacturing investment and job growth, which is crucial to restoring a healthy California economy.

CalTax also urged BOE staff to interpret and draft qualification and eligibility criteria to be as broad and inclusive as possible. They believe this approach is consistent with the Governor and Legislature's intent to maximize utilization of the exemption and to promote economic growth. CalTax further recommended that Regulation 1525.4 specifically include declaratory intent language to that effect.

Alternatively, Lockheed cautioned against a broad interpretation of RTC section 6377.1 to ensure that California's economic development budget has a balanced allocation of incentives. Lockheed recommended limiting the North American Industry Classification System (NAICS) eligibility to hold down the cost of the program and ensure a balanced overall economic development structure. Lockheed also commented that the current definition of R&D is very broad and will invite low end R&D. Lockheed suggested that BOE consider using a definition that would restrict participation to high value work.

Staff agrees that the purpose of RTC section 6377.1 is to promote economic growth in California and has drafted its proposed revisions with this in mind. However, staff does not believe it is necessary to include a statement of intent in the proposed regulation.

General information on NAICS codes

The partial exemption under RTC section 6377.1 is limited to persons primarily engaged in lines of business described in certain NAICS codes. Before discussing the definition of a qualified person, a general explanation of the code system may be helpful. The NAICS was developed under the direction and guidance of the Office of Management and Budget as the standard for use by Federal statistical agencies in classifying business establishments for the collection, tabulation, presentation, and analysis of statistical data describing the US economy. NAICS replaced the Standard Industrial Classification (SIC) system in 1997.

According to the US Census Bureau website, there is no central government agency with the role of assigning, monitoring, or approving NAICS codes for establishments. The Census Bureau assigns one NAICS code to each establishment based on its primary activity (generally the activity that generates the most revenue for the establishment) to collect, tabulate, analyze, and disseminate statistical data describing the economy of the United States. The Census Bureau also provides a search feature on their website at www.census.gov/naics that allows users to search for a NAICS code by keyword or code number. Various other government agencies, trade associations, and regulation boards adopted the NAICS classification system to assign codes to their own lists of establishments for their own programmatic needs. Generally, codes are derived from information that the business establishment has provided on surveys, forms or administrative records. For example, when a taxpayer registering with BOE does not know their

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NAICS code, they enter information about their type of business and then select a NAICS code from a list of codes generated by BOE's registration system.

Definition of qualified person – 1525.4 (b)(8)(A)

Under the prior partial exemption for manufacturing equipment, qualified taxpayers were required to be engaged in the manufacturing lines of business described in specified SIC codes. RTC section 6377.1 is broader as it includes specified research and development activities (NAICS codes 541711, or 541712); however, the section is narrower in that it requires the person be *primarily* engaged in those lines of business described in NAICS codes 3111 to 3399, 541711, or 541712. This “primarily engaged” requirement is also found in Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*.

Also modeled after Regulation 1525.2, Regulation 1532 provides a partial exemption for purchases of qualified equipment that will be used by a qualified person primarily engaged in teleproduction or other postproduction services. When Regulation 1532 was drafted, staff initially interpreted the term “qualified person” to mean the entire entity (e.g., a corporation) and that the entire entity must be “primarily engaged” in teleproduction or other postproduction activities in order to qualify for the partial exemption. However, as the drafting of the regulation progressed, a more liberal interpretation was adopted to be consistent with Regulation 1525.2 and staff applied the primarily engaged test based on establishments within the entity.

Looking at Regulation 1532 for guidance, staff proposed in the second discussion paper to define “primarily engaged” to mean 50 percent or more of gross revenues, including intra-company charges, are derived from manufacturing or research and development activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in those activities in the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used.

Interested parties pointed out that for taxpayers engaged in manufacturing and research and development, R&D activities are considered expenses, not revenues. Consequently, defining primarily engaged based on gross revenues would disqualify many taxpayers. CalTax suggested the regulation provide that a taxpayer qualifying as primarily engaged at an entity level be considered a qualified person and would not need to further qualify at the establishment level. However, taxpayers that do not qualify at the entity level may still be qualified persons based on activities at the establishment level. CalTax further recommended that “establishment” reflect various principles outlined in the NAICS, SIC, MIC, and Regulation 1532; specifically:

- That “establishment” means an economic unit where business is conducted or where services or manufacturing or research and development activities or other industrial operations are performed,
- That business activities conducted at different physical locations be treated as separate establishments,

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- Where distinct and separate business activities are performed at a single physical location, each activity shall be treated as a separate establishment, and
- That establishment is defined to mean the smallest operating unit for which separate reports are prepared for revenue, costs, number of employees, wages or salaries, sales or receipts, property and equipment, job costing, profit center accounting, or any other type of financial data.

CalTax also recommended that the qualified person test include both intra-company and inter-company charges.

Taking interested party comments into consideration, staff has revised its proposed definitions of “primarily engaged” and “establishment.” Staff recommends a single test approach based on the line of business of each respective establishment in California, rather than examining all of the activities of an entire entity, which may be national or international in scope. “Primarily engaged” would mean 50 percent or more of gross revenues, including inter- and intra-company charges, are derived from qualifying manufacturing activities of the taxpayer’s preceding financial year. For research and development activities, “primarily engaged” would mean 50 percent or more of the expenses of the establishment are for qualifying research and development activities in the taxpayer’s preceding financial year.

“Establishment” is defined as a single physical location where economic activity is conducted. For example, a factory, mill, store, winery, warehouse, research and development building, or manufacturing plant is generally a single physical location. If a single entity conducts different economic activities at multiple different establishments in the same geographic area, such as a group of separate buildings arranged in campus setting, each building or structure shall be considered a separate establishment. Staff believes these revisions are consistent with the NAICS code guidance and address the concerns of interested parties without broadening the regulation to the point that “primarily engaged” has no meaning.

Construction contracts for special purpose buildings – 1525.4 (b)(9)(A)4. and (g)

Staff added a new section to address several concerns brought up by interested parties with regard to construction contracts for special purpose buildings. The new section:

- Explains that the contractor terms used in Regulation 1525.4 are defined in Regulation 1521, *Construction Contractors*.
- Explains the general use of resale and exemption certificates when purchasing materials, fixtures, machinery and equipment that will be furnished and installed on construction contracts for qualified persons.
- Explains that contractors need to obtain a partial exemption certificate (as described in Appendix A) from the qualified person when they perform a contract for the construction of special purpose building and foundation.

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- Clarifies when a contractor may also be considered a qualified person and may issue a partial exemption certificate for items they purchase for their own use in qualifying manufacturing or research and development activities.
- Explains that in a time and material contract, the billed price of materials and fixtures will be considered the sales price of those items to the qualified person for purposes of the \$200,000,000 limit imposed in subdivision (d)(1). In a lump-sum contract, the qualified person will need to obtain this information from job cost sheets or other costing data provided by the construction contractor.

Other revisions

In addition to the above changes, the following revisions were made:

- 1525.4 (a) – Added a reference to leases to clarify that the partial exemption also applies to lease transactions.
- 1525.4 (b)(2) – Clarified the definition of “manufacturing” to explain that tangible personal property will be treated as having greater functionality if improved to increase efficiency.
- 1525.4 (b)(3) – Explained that “packaging” includes repackaging of manufactured goods when repackaging is required to meet the needs of a specific customer. Further clarified that “packaging” excludes packaging necessary to consolidate finished goods for shipping or to protect finished goods during transportation to the customer.
- 1525.4 (b)(4) and (b)(9)(A) 3. – Clarified that the applicable pollution standards are the ones in place at the time the qualified pollution control property is purchased.
- 1525.4 (b)(6) – Clarified that “process” includes testing products for quality assurance of finished goods.
- 1525.4 (b)(9)(A) 4. a. – Clarified that special purpose buildings and foundations include buildings and foundations when the building does not have a ceiling or enclosed walls.
- 1525.4 (b)(9)(B) 2. – Clarified that the extraction process includes severance activities such as mining, oil, and gas extraction.
- 1525.4 (b)(10) – Deleted “shredding” and “grinding” from the list of activities that are not considered recycling activities. There may be situations where these activities change the physical properties of waste and would be considered recycling activities. Staff notes, however, that the person performing the activity must still be a qualified person engaged in a line of business described by a qualifying NAICS code.
- 1525.4 (c)(1) – Clarified that retailers may accept a partial exemption certificate issued by a purchaser that expects to be a qualified person pursuant to subdivision (b)(8)(A).

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- 1525.4 (c)(2) – Explained that retailers who have an electronic direct purchase order system (instead of accepting traditional written purchase orders) may still use blanket partial exemption certificates.
- 1525.4 (c)(5) – Deleted the final sentence of the paragraph explaining that a seller cannot accept an exemption certificate in good faith when they have knowledge that the property is not subject to the partial exemption or will be used in a non-qualifying manner. Staff agrees that the remaining information in the paragraph covers the good faith issue.
- 1525.4 (d)(1) – Clarified that the \$200,000,000 limit on qualified purchases includes fixtures and materials sold or used in the construction of a special purpose building. Further clarified that the \$200,000,000 limit is not prorated if the purchaser is a qualified person for only a portion of a calendar year.
- 1525.4 (f) – Explained that partial exemption continues to apply to qualifying leases following the one-year test period provided in subdivision (d)(2).
- 1525.4 (h) – Explained when qualified purchasers may file a claim for refund for the partial exemption directly with BOE and when a claim for refund must be filed by the retailer who reported the original sales transaction.
- 1525.4 Appendix A and B – Added a check box on Appendix A for qualified purchasers to check for special purpose buildings and foundations. On both Appendix A and B added a statement regarding the use of the certificate as a blanket or specific exemption certificate.

Reference to Regulation 1705, Relief from Liability

Interested parties also recommended that Regulation 1525.4 reference Regulation 1705, *Relief from Liability*, to encourage taxpayers that are unsure if their transactions qualify for the partial exemption to request a written opinion from the Board. Although staff does not believe it is necessary to add this clarification in the regulation, we will include it on our industry webpage for manufacturers and in other information provided to taxpayers.

VI. Summary

Staff welcomes any comments, suggestions, and input from interested parties on this issue. Staff also invites interested parties to participate in the February 18, 2014, interested party meeting.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 1/30/14

The underline and strikethrough text shows changes from the text proposed in staff's second discussion paper. Because this is a new regulation, all of the proposed text will be underlined when the issue is presented to the Board.

Regulation 1525.4, Manufacturing and Research & Development Equipment

Reference: Section 6377.1, Revenue and Taxation Code

(a) PARTIAL EXEMPTION FOR PROPERTY PURCHASED FOR USE IN MANUFACTURING AND RESEARCH AND DEVELOPMENT. Except as provided in subdivision (d), beginning July 1, 2014, and before July 1, 2022, section 6377.1 of the Revenue and Taxation Code (RTC) provides a partial exemption from sales and use tax for certain sales, and purchases, and leases of tangible personal property as described in this regulation.

For the period beginning July 1, 2014, and ending on December 31, 2016, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC and Section 36 of Article XIII of the California Constitution (4.1875%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

For the period beginning January 1, 2017, and ending on June 30, 2022, the partial exemption applies to the taxes imposed by sections 6051 (except the taxes deposited pursuant to section 6051.15), 6051.3, 6201 (except the taxes deposited pursuant to section 6201.15), and 6201.3 of the RTC (3.9375%). The partial exemption does not apply to the taxes imposed or deposited pursuant to sections, 6051.2, 6051.5, 6051.15, 6201.2, 6201.5, or 6201.15 of the RTC, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of Article XIII of the California Constitution.

Subject to the limitation set forth above, this partial exemption from tax applies to the sale of and the storage, use, or other consumption in this state, of the following items:

(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 subdivision (a) (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, provided that the qualified person that will use that the resulting improvement to real 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) DEFINITIONS. For the purposes of this regulation:

(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. Tangible personal property shall be treated as having a greater service life if such property can be used for a longer period than such property could have been used prior to the conversion or conditioning of such property. Tangible personal property shall be treated as having greater functionality if it has been improved in such a manner that it is more efficient or can be used to perform new or different functions.

(3) “Packaging” means to wrap, seal, box, or put together as a unit, but includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person’s finished goods inventory, or to prepare goods so that they are suitable for delivery to and placement in finished goods inventory, including repackaging of such goods when repackaging is required to meet the needs of a specific customer. ~~Any additional packaging, such as that p~~ Packaging necessary to consolidate the goods prior to shipping or to protect them during transportation to the customer, shall not be considered to be “packaging” for purposes of this regulation.

(4) “Pollution control” means any activity that results in the abatement, reduction, or control of water, land, or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat, but only to the extent that such activity meets or exceeds standards established by this state or by any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

(5) “Primarily” means 50 percent or more of the time.

(6) “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 as defined in subdivision (b)(3), if required. “Process” includes testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form, including packaging as defined in subdivision (b)(3), 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.

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

(8) (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. For the purpose of this subdivision:

1. "Primarily engaged" means 50 percent or more of gross revenues, including inter-company and intra-company charges, are derived from the-qualifying manufacturing ~~or research and development~~ activities described in subdivisions (a)(1) ~~—and (a)(3)~~ for the financial year of the purchaser preceding the purchase of the property. In the case of a nonprofit organization, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to such qualifying manufacturing activities.

For purposes of determining if a purchaser is "primarily engaged" in research and development activities described in NAICS 541711 or 541712, "primarily engaged" means 50 percent or more of the expenses of the establishment are for such qualifying research and development activities as described in subdivisions (a)(2) and (a)(3) for the financial year of the purchaser preceding the purchase of the property.

In cases where the purchaser was not primarily engaged in qualifying manufacturing or research and development activities for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used. ~~In the case of a nonprofit organization, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to qualifying activities.~~

2. For purposes of classifying a line or lines of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the economic activity in which the establishment is primarily engaged. establishment's single most predominant activity based upon gross revenue, including intra-company charges. An establishment is not necessarily identical with the enterprise or company which may consist of one or more establishments. Also, an establishment is to be distinguished from subunits of the establishment such as departments. The term "establishment" means a single physical location where economic activity is conducted, such as manufacturing, construction, wholesale, research and development, or other such economic activities for which the NAICS provides a code. A single physical location includes a building, interconnected structure, or other such improvement to realty. For example, a factory, mill, store, winery, warehouse, research and development building, or manufacturing plant is generally a single physical location. If a single entity or enterprise conducts different economic activities at multiple different establishments in the same geographic area, such as a group of separate and distinct buildings arranged in a campus setting, each building or structure shall be considered a separate establishment.

Where a single establishment derives gross revenue from manufacturing activities and also engages in research and development activities at a single physical location, the two activities shall each be examined separately. That is, if 50 percent or more of gross revenue at that single establishment are from qualifying manufacturing activities or 50 percent or more of total expenses of the establishment are for qualifying research and development activities, then the establishment qualifies and all purchases of qualified tangible personal property qualify for the partial exemption.

3. An establishment primarily engaged in manufacturing activities may purchase qualified tangible personal property for use in research and development subject to the partial exemption, and vice versa, provided all other requirements for exemption are met. Where a person conducts business at more than one establishment ~~within the meaning of this subdivision,~~ then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in an establishment in which the purchaser 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 subdivision (b)(8)(A), "qualified person" does not include:

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

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

In general, these apportioning trades or businesses derive more than 50 percent of their gross business receipts from an agricultural business activity, an extractive business activity, a savings and loan activity, or a banking or financial business activity.

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

1. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. For purposes of this subdivision, manufacturing aids as described in Regulation 1525.1, *Manufacturing Aids*, may be considered machinery and equipment, when purchased by a qualified person for use by that person in a manner qualifying for exemption, even though such property may subsequently be delivered to or held as property of the person to whom the manufactured product is sold. The manufacturing aids must meet the useful life requirement of subdivision (b)(13).

2. 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.

3. Tangible personal property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state at the time the qualified tangible personal property is purchased.

4. 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. For purposes of this subdivision:

a. "Special purpose building and foundation" means only a building and the foundation ~~immediately~~ underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subdivision (a) ~~of this regulation~~ (the qualified purpose). Special purpose buildings and foundations also include foundations for open air structures that may not have ceilings or enclosed walls but are used exclusively for the specified purposes as set forth in subdivision (a).

b. A building or foundation is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building or foundation for the intended purpose and then use the structure for a different purpose.

c. A building or foundation is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building or foundation for nonqualified purposes does not preclude the ~~building-structure~~ from being a special purpose building and foundation. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

d. If an entire building and/or foundation does not qualify as a special purpose building and foundation, a taxpayer may establish that a portion of ~~the a building structure, and the foundation immediately underlying the portion,~~ qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subdivision.

e. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose ~~manufacturing,~~ industrial, or commercial building; or storage facilities that are used primarily before the point raw materials are introduced into the process and/or after the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form.

f. The term "integral part" means that the special purpose building or foundation is used directly in the activity qualifying for the partial exemption from sales and use tax and is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

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

1. Consumables with a useful life of less than one year.
2. 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. [The extraction process includes such severance activities as mining, oil and gas extraction.](#)

3. Tangible personal property used primarily in administration, general management, or marketing.

(10) "Recycling" means the process of modifying, changing, or altering the physical properties of manufacturing, processing, refining, fabricating, secondary or postconsumer waste which results in the reduction, avoidance or elimination of the generation of waste, but does not include transportation, baling, ~~shredding, grinding,~~ compressing, or any other activity that does not otherwise change the physical properties of any such waste.

(11) "Refining" means the process of converting a natural resource to an intermediate or finished product, but does not include any transportation, storage, conveyance or piping of the natural resources prior to commencement of the refining process, or any other activities which are not part of the process of converting the natural resource into the intermediate or finished product.

(12) "Research and development" means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder. Research and development shall include activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. For this purpose, uncertainty exists if the information available to the qualified taxpayer does not establish the capability or method for developing or improving the product or the appropriate design of the product.

(13) "Useful life." ~~for t~~Tangible personal property that the qualified person treats 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 regulation. ["Useful life" for t](#)Tangible personal property that the qualified person treats 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 regulation.

(c) PARTIAL EXEMPTION CERTIFICATE.

(1) IN GENERAL. Qualified persons who purchase or lease qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

[On occasion a potential qualified person may not know at the time of purchase whether they will meet the requirements for the purpose of claiming the partial exemption until the expiration of the one year period following the date of purchase as provided in subdivision \(b\)\(8\)\(A\). The purchaser may issue a partial exemption certificate at the time of the purchase based on the expectation that the purchaser will meet the requirements of the regulation. If those requirements are not met, the purchaser will 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 purchased.

If the purchaser pays the full amount of tax at the time of purchase and later becomes aware that the requirements of this regulation are met, they may issue a partial exemption certificate to the retailer. If a retailer receives a certificate from a qualified person under these circumstances, the retailer may file a claim for refund as provided in subdivision (h).

The exemption certificate form set forth in Appendix A may be used as an exemption certificate.

Contractors purchasing property for use in the performance of a construction contract for a qualified person as described in subdivision (a)(4), who purchase qualified tangible personal property from an in-state retailer, or an out-of-state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a timely partial exemption certificate in the proper form as set forth in subdivision (c)(3) and in good faith as defined in subdivision (c)(4), from the contractor, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation.

The exemption certificate form set forth in Appendix B may be used as an exemption certificate.

(2) BLANKET PARTIAL EXEMPTION CERTIFICATE. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The partial exemption certificates forms set forth in Appendix A and Appendix B may be used as blanket partial exemption certificates. In absence of evidence to the contrary, a retailer may accept an otherwise valid blanket partial exemption certificate in good faith if the certificate complies with the requirements set forth in this subdivision.

Qualified persons or contractors claiming the partial exemption through a blanket exemption certificate ~~must~~ may identify transactions subject to the partial exemption by making make a clear reference to the blanket partial exemption certificate in a contemporaneous document or in documents such as their written purchase orders, sales agreements, leases, or contracts. Such documents referencing the blanket partial exemption certificate must include a description of the property being purchased.

When purchasing tangible personal property not qualifying for the partial exemption from a seller to whom a blanket exemption certificate has been issued, the qualified person or contractor must clearly state in a contemporaneous document or documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

If contemporaneous physical documentation, such as a purchase order, sales agreement, lease, or contract is not presented for each transaction, any agreed upon designation which clearly indicates which items being purchased are or are not subject to the partial exemption certificate, such as using a separate customer account number for purchases subject to the partial exemption, will be accepted, provided the means of designation is set forth on the blanket exemption certificate.

(3) FORM OF PARTIAL EXEMPTION CERTIFICATE. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial

exemption certificate with respect to the sale or purchase of the tangible personal property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name, address and telephone number of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property purchased is:

1. To be used primarily for a qualifying activity as described in subdivision (a)(1) – (3), or

2. For use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person as described in subdivision (a)(4).

(E) A statement that the purchaser is:

1. a person primarily engaged in a manufacturing business described in NAICS Codes 3111 to 3399 or in research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

2. a contractor performing a construction contract for a qualified person primarily engaged in manufacturing business described in NAICS Codes 3111 to 3399 or in a research and development activities as described in NAICS Codes 541711 and 541712 (OMB 2012 edition).

(F) A statement that the property purchased is qualified tangible personal property as described in subdivision (7)(A).

(G) A description of property purchased.

(H) The date of execution of the document.

(4) RETENTION AND AVAILABILITY OF PARTIAL EXEMPTION CERTIFICATES. A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the partial exemption certificate.

(5) GOOD FAITH. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person or a contractor performing a construction contract for a qualified person provides a certificate meeting the requirements provided in subdivision (c)(3). ~~However, a partial exemption~~

~~certificate cannot be accepted in good faith where the seller has knowledge that the property is not subject to a partial exemption, or will not be otherwise used in a partially exempt manner.~~

(d) WHEN THE PARTIAL EXEMPTION DOES NOT APPLY. The exemption provided by this regulation shall not apply to either of the following:

(1) Any tangible personal property purchased by a qualified person 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 the qualified person under this regulation. This limit includes fixtures and materials sold or used in the construction of special purpose buildings and foundations.

For purposes of this subdivision, in the case of a qualified person that is required to be included in a combined report under RTC section 25101 or authorized to be included in a combined report under RTC section 25101.15, the aggregate of all purchases of qualified personal property for which an exemption is claimed pursuant to this regulation 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.

For the purposes of this subdivision, “calendar year” includes the period July 1, 2014 to December 31, 2014, and as well as the period January 1, 2022 to June 30, 2022. Accordingly, for calendar years 2014 and/or 2022, a qualified person may not exceed \$200,000,000 in purchases of qualified tangible personal property for which an exemption is claimed by the qualified person under this regulation.

There is no proration of the \$200,000,000 limit when the purchaser is a qualified person for only a portion of a calendar year. For example, if the qualified person began business on October 1, 2016, the qualified person’s purchases of qualified tangible personal property may claim up to \$200,000,000 in the three months of 2016 they were in business.

(2) 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.

(e) PURCHASER’S LIABILITY FOR THE PAYMENT OF SALES TAX. 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 subdivision (d)(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) LEASES. Leases of qualified tangible personal property classified as “continuing sales” and “continuing purchases” in accordance with Regulation 1660, *Leases of Tangible Personal Property – In General*, may qualify for the partial exemption subject to all the limitations and

conditions set forth in this regulation. The partial exemption established by this regulation may apply to rentals payable paid by a qualified person for a lease period beginning on or after July 1, 2014, with respect to a lease of qualified tangible personal property to the qualified person, which property is shall apply to the rentals payable pursuant to the lease, provided the lessee is a qualified person and the tangible personal property is used primarily in an activity described in subdivision (a), notwithstanding the fact that the lease was entered into prior to the effective date of this regulation.

For purposes of this subdivision, in the case of any lease that is a continuing "sale" and "purchase" under subdivision (b)(1) of Regulation 1660, the one-year test period specified in subdivision (d)(2) of this regulation runs from the date of the first rental period which occurs on or after July 1, 2014, provided that the other conditions for qualifying for the partial exemption have been met. Any such rentals payable subject to the partial exemption shall continue to be taxed at the partial rate after expiration of the one-year period and lasting until such time as the lessee ceases to be a qualified person, converts the property for use in a manner not qualifying for the exemption, uses the property in a manner not qualifying for the partial exemption, or the partial exemption otherwise ceases to apply.

The exemption applies to lease payments for use of the qualifying property during the period the partial exemption is in effect. For example, a 10-year lease begins January 1, 2013 and ends December 31, 2023. The lease payments for use from July 1, 2014 to December 31, 2022 qualify for the partial exemption.

(g) CONSTRUCTION CONTRACTORS. The application of sales and use tax to construction contracts is explained in Regulation 1521, *Construction Contractors*. The terms "construction contract," "construction contractor," "materials," "fixtures," "time and material contract," and "lump sum contract" used in this regulation refer to the definitions of those terms in Regulation 1521. Nothing in this regulation is intended to alter the basic application of tax to construction contracts.

As provided in subdivision (c)(1), construction contractors performing construction contracts for construction of special purpose buildings and foundations should obtain a partial exemption certificate from the qualified person (Appendix A). Contractors purchasing property from a retailer in this state or engaged in business in this state for use in the performance of a qualifying construction contract for a qualified person must timely furnish the retailer with a partial exemption certificate in order for the partial exemption to be allowed (Appendix B).

Equipment used by a construction contractor in the performance of a construction contract for a qualified person does not qualify for the partial exemption. For example, the lease of a crane used in the construction of a special purpose building does not qualify. However, a contractor that is also a qualified person as defined in subdivision (b)(8) because, for example, the contractor manufactures tangible personal property for retail sale may purchase property subject to the partial exemption if all other requirements for the exemption are met.

As explained in subdivision (d)(1), the \$200,000,000 limit for the partial exemption includes fixtures and materials sold or used in the construction of special purpose buildings and foundations. In a time and material contract, the qualified person may consider the billed price of materials and fixtures to be the purchase price of these items for the purposes of the limit. In a lump-sum contract, the qualified person must obtain this information from job cost sheets or other cost information provided by the construction contractor.

(h) CLAIM FOR REFUND. Qualified purchasers who paid tax or tax reimbursement to the seller or the Board and who thereafter issue a partial exemption certificate to the seller, may file a claim for refund with the Board if the purchase was a use tax transaction; however, if the purchase was a sales tax transaction, a claim for refund for sales tax must be filed by the retailer who reported the sale. In order to be timely, the claim for refund must be filed with the Board within the period specified in section 6902 of the RTC.

Appendix A

**PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING AND
RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1**

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and ~~from~~ at the rate of 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction. This partial exemption also applies to lease periods occurring on or after July 1, 2014 and before July 1, 2022, for leases of qualified tangible personal property even if the lease agreement was entered into prior to July 1, 2014.

I hereby certify that the tangible personal property described below and purchased or leased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me primarily (please check one):

- 1. for manufacturing, processing, refining, fabricating, or recycling, or
- 2. for research and development, or
- 3. to maintain, repair, measure, or test any property being used for (1) or (2) above, or-
- 4. as a special purpose building and/or foundation.

Description of qualified tangible property purchased or leased^{1*}:

*See Regulation 1525.4 (b)(9) for a description of what is included and excluded from "qualified tangible personal property." If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file. You must reference this blanket certificate on future purchase orders or on other designation as provided in Regulation 1525.4 (c)(2).

I, as the undersigned purchaser, hereby certify I am primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)² or I am primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if the purchase exceeds the \$200 million limitation, or if such property is, within one year from the date of purchase or lease, removed from California, converted for use in a manner not qualifying for the exemption, or used in a manner not qualifying for the partial exemption that I am required by the Sales and Use Tax Law to report and pay the state tax measured by the sales price/rentals payable of the property to/by me at the time the tangible personal property is so purchased, removed, converted, or used.

¹ See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

² Published by the US Office of Management and Budget, 2012 edition.

~~I further understand that the Section 6377.1 partial exemption is limited to \$200 million in qualifying purchases per qualified person per calendar year.~~

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

Appendix B

**CONSTRUCTION CONTRACTS - PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING
AND RESEARCH & DEVELOPMENT EQUIPMENT – SECTION 6377.1**

This is a partial exemption from sales and use taxes at the rate of 4.1875% from July 1, 2014 to December 31, 2016, and ~~from at the rate of~~ 3.9375% from January 1, 2017 to June 30, 2022. You are not relieved from your obligations for the remaining state tax and local and district taxes on this transaction.

I hereby certify that the tangible personal property described below and purchased from:

SELLER'S/LESSOR'S NAME

SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

is qualified tangible personal property and will be used by me in the performance of a construction contract for a qualified person who 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.

Description of qualified tangible property purchased^{*1}:

~~*See Regulation 1525.4 (b)(9) for a description of what is included and excluded from “qualified tangible personal property.” If this is a specific partial exemption certificate, provide the purchase order or sales invoice number and a precise description of the property being purchased. If you want this certificate to be used as a blanket certificate for future purchases, describe generally the type of property you will be purchasing and ask your vendor to keep this certificate on file. You must reference this blanket certificate on future purchase orders or other designation as provided in Regulation 1525.4 (c)(2).~~

I further certify I am performing a construction contract for a qualified person primarily engaged in manufacturing, processing, refining, fabricating, or recycling as described in Codes 3111 to 3399 of the North American Industry Classification System (NAICS)^{†2} or primarily engaged in biotechnology, or physical, engineering, and life sciences research and development as described in Codes 541711 and 541712 of the NAICS.

I understand that if I use the property for any purpose other than indicated above, I am required to report and pay the state tax measured by the sales price of the property to me.

NAME OF PURCHASER	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	
PERMIT NUMBER (IF YOU ARE NOT REQUIRED TO HOLD A PERMIT, EXPLAIN WHY)	TELEPHONE NUMBER
EMAIL ADDRESS OF PERSON SIGNING	DATE

¹ See Regulation 1525.4, subdivision (b)(9) for a description of what is included and excluded from “qualified tangible personal property.”

^{†2} Published by the US Office of Management and Budget (OMB), 2012 edition.



December 19, 2013

TO: Susanne Buehler
Chief, Tax Policy Division
Sales and Use Tax Department
Board of Equalization

FROM: California Manufacturers & Technology Association
Nicole Rice, Policy Director for CMTA

RE: **Comments on Proposed Regulation 1525.4**
(Manufacturing and Research & Development Equipment)

The California Manufacturers & Technology Association (CMTA) respectfully submits the following comments on the proposed regulation to establish a partial sales and use tax exemption for manufacturing and research & development equipment purchases.

The passage of Assembly Bill 93 (Stats. 2013, Ch. 69) and Senate Bill 90 (Stats. 2013, Ch. 70) sends a strong message that California wants to attract new investment and values high wage manufacturing employment. The Governor and the Legislature have made it clear that the purpose of this tax policy is to incentivize manufacturing investment and job growth in California. According to the Governor, "This legislation will help grow our economy and create good manufacturing jobs ... Through our great university system and through the companies we have, California can build on the strength of intellectual capacity. Let's get to work!"

To enable us to "get to work," we urge staff to draft the regulation to reflect a broad and liberal interpretation of the authorizing statute. Narrow interpretations and overly-complicated compliance requirements could put a damper on manufacturers' willingness to take advantage of the exemption. Our recommendation will encourage full use of the exemption and limit the potential for punitive audits and penalties that would undermine the purpose to incentivize investment.

Our recommendation will increase manufacturing investment and job growth, which is crucial to restoring a healthy California economy:

- When the Manufacturing Investment Tax Credit ended in 2004, California became one of only five states that did not provide either an exemption or credit to offset the cost of the

Susanne Buehler
Board of Equalization

December 19, 2013
Page Two

sales tax, which created a competitive disadvantage for California manufacturers and discouraged new investment. According to Conway Data, a firm that surveys the country to compare rates of manufacturing investments for new facilities or expansions, since 2001 California has annually received only 1.8% of these investments, down from an average of 5.6% between 1977 and 2000. This is a disturbing trend that is far short of the levels of investment we need to maintain our 11% share of US manufacturing GDP.

- In 2002, the Milken Institute conducted a study that found California's economic incentives and long-term economic strategy to be lacking but offered that a five-cent reduction in sales tax on manufacturing equipment purchases would create 500,000 jobs over 10 years, with 140,000 of those jobs being created in manufacturing and \$459 million in new net state revenue being generated. These tax revenues greatly exceed the cost to the state's General Fund for providing the exemption.
- The sales tax exemption is a form of tax relief that occurs just at the right time to influence important business decisions. Manufacturers weigh the cost of new equipment in some instances as heavily as the cost and availability of workforce when deciding where to invest. Making sure California is more cost competitive with other states that exempt such purchases from sales tax is crucial at this time.
- California is slowly coming out of the recession when lower demands for products meant company cost-cutting and less capital spending. Now manufacturers are considering new investments to serve growing markets and develop new products. They need to purchase new equipment but will avoid extra costs wherever possible. California is sending a strong message that it is a good place to make major capital investments for the next business cycle and beyond.
- California manufacturers are extremely diverse, with every type of product represented. One constant feature is every manufacturer has a need for continual modernization to build new products, meet environmental and safety standards, and increase the skill level of its workforce. The equipment needed to meet these goals can be very expensive with a relatively long pay back. Lowering the cost will make it easier for companies to succeed in the state.

Thank you for considering these comments as you draft regulations to implement this important policy and we look forward to the release of the next draft.

From: [Buehler, Susanne](#)
To: [Whitaker, Lynn](#); [Oakes, Clifford](#); [Stark, Kirsten](#)
Subject: FW: CalTax Comments to Proposed Reg 1525.4 -- Second Discussion Paper
Date: Thursday, December 19, 2013 11:00:42 AM
Attachments: [Comments to BOE Manuf SUT Exemption 12-18-13.docx](#)

From: Therese Twomey [mailto:Therese@caltax.org]
Sent: Thursday, December 19, 2013 10:34 AM
To: Buehler, Susanne
Subject: CalTax Comments to Proposed Reg 1525.4 -- Second Discussion Paper

Susanne,

Attached please find CalTax's comments to BOE's second discussion paper pertaining to proposed regulation 1525.4, dealing with the sales/use tax exemption for manufacturing and research-and-development equipment. Please let me know if you have any questions, or would like to discuss our submittal. Thank you.

Therese Twomey

Fiscal Policy Director
California Taxpayers Association
1215 K Street, Suite 1250
Sacramento, CA 95814
916.930.3105
therese@caltax.org
www.caltax.org



As of December 18, 2013

**Comments to State Board of Equalization's Proposed Regulation
1525.4 (Manufacturing and Research & Development Equipment)**

General Observations:

1. The sales/use tax exemption for manufacturing and research-and-development equipment was enacted to make California more competitive and to promote economic growth. In presenting the proposal to the Legislature, Governor Brown wrote, the proposal “aims to ... bolster California's business environment and reintegrate people into the workforce,” and “It will allow California to be more effective at stimulating economic growth and creating new jobs.” The Legislature reaffirmed that commitment, and went even further to assure economic activity by requiring the Board of Equalization (BOE) to annually report to the Legislature the total dollar amount of exemptions taken, and to “identify options for increasing exemptions taken,” in the event exemptions are lower than estimated.

The BOE's second discussion paper, as currently drafted, would prevent many of California's major manufacturers and employers from claiming the exemption. CalTax again strongly urges BOE staff to interpret and draft qualification/eligibility criteria to be as broad and inclusive as possible – consistent with the governor and Legislature's intent to maximize utilization of the exemption, and to promote economic growth. We have some recommendations below for how to move in that direction.

2. The statutes enacting the sales/use tax exemption were based on many of the goals and concepts developed under the former Manufacturers' Investment Credit (MIC), namely the intent to generate economic activity. In deciding many of the appeals brought before the BOE, the board has repeatedly stated in four published opinions spanning several years that “underlying our approach to the MIC is our belief that the MIC should be interpreted liberally in favor of taxpayers.” We believe this should be the guiding principle in drafting the regulation, and that the regulation should specifically include declaratory intent language to that effect.

Specific Comments:

1. The statutes allow taxpayers who are primarily engaged in specified lines of business described in the North American Industry Classification System (NAICS) codes, and who purchase qualifying equipment, to be eligible for the exemption. The statutes define “primarily engaged” to mean 50 percent or more of the time, for purposes of determining whether a taxpayer is engaged in a qualifying line of business. The regulation proposes to measure “primarily engaged” based on gross revenues determined for the “establishment”. While this measurement may be applicable to some industries, it would disqualify many taxpayers engaged in manufacturing and research and development (R&D). The Legislature structured the exemption to apply to different industries, and given that there are numerous ways in which industries – and even companies within the same industry – may be organized, the one-size-fits-all measurement of gross revenue is too restrictive and not workable. We strongly recommend that the proposed regulation provide for several different tests to determine “primarily engaged”, and so long as a taxpayer meets one of those tests, the taxpayer is considered “primarily engaged” in a qualifying line of business.

First, we need to go back to the specific language of the statute, which intends eligibility for taxpayers who are manufacturers and R&D companies under the qualifying NAICS codes. These businesses are clearly “primarily engaged” in manufacturing or R&D, as such activities constitute their dominant or primary operation at the entity level. Therefore, the regulation should define these entities to be qualified taxpayers for purposes of the exemption, without further measurement criteria. Companies that qualify at the entity level would not need to further qualify at the establishment level. We believe this approach underscores a clear reading of the statutes.

Second, if a taxpayer does not meet the first test, or for those taxpayers who are engaged in multiple lines of business, the regulations should provide alternative measurements for determining “primarily engaged” for an establishment. We urge BOE staff to consider measurements, such as the number of employees in an activity, number of units processed, production valued, and other factors. And so long as a taxpayer satisfies one of these measurements – either as an entity or an establishment – the taxpayer is determined to be a qualified taxpayer.

2. The proposed regulation determines eligibility at the “establishment” level, and appears to disqualify operating units within a company that perform manufacturing or R&D. We recommend, along with the alternative measurements discussed above, that “establishment” reflect some of the principles repeatedly outlined in the NAICS, SIC, MIC and Regulation Section 1532, and be defined using the following guidelines:

“Establishment shall mean an economic unit where business is conducted or where services or manufacturing or research-and-develop activities, or other industrial operations are performed. For example, a factory, mill, store, etc.

Business activities conducted at different physical locations shall be treated as separate establishments.” Thus for example, if a taxpayer manufactures clay tiles in Los Angeles, and operates a retail tile store in Tarzana, each of these activities would be treated as a separate establishment.

Where distinct and separate business activities are performed at a single physical location (such as construction activities operated out of the same physical location as a lumber yard), each activity shall be treated as a separate establishment.

Establishment is also defined to mean the smallest operating unit for which separate reports are prepared for revenue, costs, number of employees, wages or salaries, sales or receipts, property and equipment, job costing, profit center accounting, or any other type of financial data.”

3. Also related to the comments above, for persons conducting business at more than one establishment, the proposed regulation restricts eligibility to those purchases that are used at only the establishment where the purchaser is “primarily engaged” based on measurement of gross revenue. As drafted, the proposed regulations would disqualify manufacturing and R&D equipment purchased for use at a manufacturing and R&D facility, if a company’s gross revenue is mostly derived at a different location or establishment.

Again, because of the different ways in which businesses may be organized, we urge BOE to provide alternative tests similar to those discussed in comments 1 and 2 above.

First, for businesses that clearly manufacture or research-and-development companies and qualify at the entity level, the regulations should specify that purchases of equipment by that entity for use primarily in manufacturing, processing, fabricating, etc. or R&D in California, are eligible for the exemption without further measurement criteria and without limitation to the establishment.

Second, if a taxpayer does not meet the first test, or for those taxpayers who are engaged in multiple lines of business, the regulations should specify that only qualifying purchases used at an establishment (as proposed to be defined in comment 2) that satisfies one of the alternative measurements for determining “primarily engaged”, are eligible for the exemption.

4. The proposed regulation provides that gross revenues include “intracompany” charges. We suggest that gross revenues also include “intercompany” charges. While “intracompany” may have been applicable to the teleproduction and postproduction industries for which Regulation 1532 was designed, it is not applicable to some other industries. Adding “intercompany” would cover the various ways in which businesses may be organized.
5. The regulation lacks guidance as it pertains to contractors, particularly with regard to the \$200 million annual cap. The regulation should clarify that, in instances where a contractor is a qualified taxpayer purchasing qualifying equipment for use in the contractor’s own projects, that contractor would be availed of a \$200 million cap separate from that availed to a consumer.
6. The proposed regulation defines “process” to include “testing products for quality assurance which occurs prior to the tangible personal property being altered to its completed form.” While the phrase “, including packing” was agreed to be added to the end of this sentence, we still have concerns that this language could cause audit problems. For example, finished semiconductors are randomly tested and if any fail, the entire batch may be discarded. Further, if the finished semiconductors are then shipped to another facility for installation in a final product, they may never be “packaged,” but simply placed in shipping containers. As drafted, this could be construed to disqualify the quality control equipment since the products are “completed,” and never packaged, when tested. We believe the qualifier should simply be deleted from the sentence, as follows:

“Process” includes testing products for quality assurance ~~which occurs prior to the tangible personal property being altered to its completed form.~~
7. The proposed regulation defines manufacturing to include improvements to tangible personal property that result in a greater useful life or a greater functionality. Greater functionality is then defined to mean that property has been “improved in such a manner that it can be used to perform new or different functions”. We are concerned that this could be construed to mean only functions that new or different would qualify, and would exclude improvements that increase efficiency or output. For example, the current definitions could be construed to exclude the manufacturing of a microchip that increases the speed of data processing, because it is not considered a “new or different” function. We recommend changing the language to define greater functionality as follows:

“Tangible personal property shall be treated as having greater functionality if it has been improved, ~~in such a manner that it can be used to~~ or performs new or different functions.”
8. In our previous submittal, we asked the BOE staff to parallel the MIC definitions in defining special purpose buildings and foundations, and to update those

definitions to reflect current-technology special purpose buildings and foundations. The proposed regulation defines special purpose building and foundation to mean “only a building and the foundation immediately underlying the building” that is constructed for installation of special purpose equipment. Since the MIC, there have been technological advances regarding special purpose buildings and foundations. The current definition would exclude special purpose foundations that are not underneath buildings (such as special purpose testing runways), and would exclude special purpose foundations supporting clean rooms that are situated in general purpose buildings. We recommend updating the definition to include these and other new-technology buildings and foundations.

9. The proposed regulation defines packaging to end at the point where the product is placed in a taxpayer’s finished goods inventory. The current definition would appear to exclude instances where finished goods are placed in inventory and shipped in bulk to another location where it is separately packaged as a single item. The proposed regulation should clarify and extend the packaging definitions to cover these circumstances.
10. A sales/use tax exemption is allowed for tangible personal property used in pollution control that meet or exceed pollution standards establish by the state or local agencies. The regulation does not address instances in which pollution standards may change between the time such property is purchased and when it is placed into operation. We recommend the proposed regulation clarify that the applicable pollution standards are the ones that are in place at the time the equipment is purchased.
11. The law allows specified purchases by contractors to qualify, as mentioned above, but does not define contractors, subcontractors, etc. The regulations should provide an inclusive definition of “contractors”, “subcontractors”, etc. and also qualify “material suppliers” who supply the raw materials for the project and are the construction contractors for the project.
12. In our previous submittal, we noted that the proposed certification process imposes a very difficult burden on in-state retailers regarding enforcement of exemption certificates and the law’s annual spending cap of \$200 million per “qualified person.” The qualified person is to provide an exemption certificate to the retailer prior to purchases being made. The retailer is not in a legal position to determine if the exemption certificate is appropriate under the customers’ specific facts and circumstances. Further, the proposed regulation allows the seller to accept the certificate in good faith if the seller is “without knowledge to the contrary.” We are concerned that is may be construed to mean the seller should have had knowledge of the circumstances, and thus may be held liable

for the tax. The “without knowledge to the contrary” test is highly subjective, and should be deleted from the regulation.

13. Section (a) of the proposed regulations provide for a partial sale/use tax exemption for “certain sales and purchases” of tangible personal property. We recommend clarifying that leases also are eligible for the exemption by changing the proposed regulation to say “certain sales, purchases and leases.”



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December 19, 2013

Ms. Susanne Buehler, Chief
Board of Equalization
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092

VIA: Email: Susanne.Beuhler@boe.ca.gov

Re: Comments related to proposed Regulation 1525.4, Manufacturing and Research & Development Equipment.

Dear Ms. Buehler,

This letter is being provided in response to the Second Discussion Paper for proposed Regulation 1525.4 issued on November 14, 2013, in addition to the interest parties meeting held on December 5, 2013. The focus of our comments relates to the portion of the law and regulation which pertains to construction contractors. As Staff is aware, the application of tax to construction contractors is unique, and it can vary depending on, among other things, the nature of the products installed and the method by which the parties contract. For that reason, errors in applying and reporting tax by construction contractors are fairly common. While the enacted legislation will likely provide for a significant opportunity for many contractors through increased construction projects, it also has the potential for creating additional sales and use tax compliance pitfalls. To help maximize compliance, we encourage Staff to err on the side of simplicity when considering regulatory language and requirements related to construction contractors.

Ms. Susanne Buehler, Chief
Proposed Regulation 1525.4
December 19, 2013
Page 2 of 3

Items which Qualify for the Exemption

Section (a)(4) of proposed Regulation 1525.4 describes property that qualifies for the exemption as including the following:

“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.” (Emphasis added)

Pursuant to Regulation 1521, a contractor, in general, is the consumer of materials and the retailer of fixtures. At page 5 of 8 of the Second Discussion Paper for proposed Regulation 1525.4, Staff comments that it believes materials *and* fixtures qualify for the exemption. The above quoted portion of proposed Regulation 1525.4, which we recognize comes directly from the same titled subdivision of Code section 6377.1, doesn't appear to account for the “sale” of fixtures; contractors technically do not “use” or consume fixtures for sales and use tax purposes. We believe any potential confusion can be reduced or avoided by adding “or sale” after the emphasized word(s) “use” above. Such language would help make it clear that materials *and* fixtures may qualify for the exemption.

“Special Purpose building and foundation”

Code section 6377.1, subdivision (b)(7)(A)(iv) provides a general description for special purpose buildings and foundations. Proposed Regulation 1525.4, subdivisions (b)(9)(4) includes the same description. The proposed Regulation, however, also includes narrowing descriptions at subdivisions (b)(9)(4)(a) through (f). In our opinion, subdivisions (a), (b) and (c) do not clarify the meaning or intent of the law. Rather, those subdivisions appear to narrow the description of “special purpose building and foundation,” and create confusion. For example, proposed Regulation 1525.4, subdivision (b)(9)(4)(a) states:

““Special purpose building and foundation” means only a building and the foundation immediately underlying the building...”

The above portion of subdivision (a) appears to exclude items such as underground plumbing and electrical works, sidewalks directly adjacent to the structure, and parking lots. A plain reading of the statute, however, does not support such a narrow interpretation. Further,

such an interpretation would significantly complicate both the available exemption for construction contractors and its administration for Board Staff. The same contractor often will be responsible for the structure, its foundation, and all of the aforementioned items. Some of the materials used for the foundation directly underlying the building, and those used for construction not directly underlying the building, may be commingled. How would a contractor determine what materials should be purchased under a partial exemption certificate, and what materials should not?

We believe the description provided at Code section 6377.1, subdivision (b)(7)(A)(iv), is sufficiently clear, and it does not require proposed Regulation 1525.4, subdivisions (b)(9)(4) (a), (b) or (c).

Establishing the Value of Qualifying Fixtures and Materials under a Construction Contract

At the second interested parties' discussion, it was expressed that Staff intended to require contractors to enter into time and material contracts with qualifying persons so the value of fixtures and materials under the contract can be established for purposes of the \$200,000,000.00 per year cap. Such a requirement is a logical one, since it may be difficult in an audit of a qualifying manufacturer to quantify the applicable value otherwise. We suggest, however, that any such requirement be limited to circumstances in which the total investment made by the manufacturer (including any acquired machinery, equipment, structures etc.), exceeds \$200,000,000.00. Further, while T&M is a viable contracting option, to promote freedom in contracting between the parties, it should not be the exclusive method allowed; and it should not be the exclusive method permitted for establishing the value of the applicable fixtures and materials under the contract. Acceptable alternatives may include job cost sheets of the contractor etc.

Finally, we believe it will be necessary to discuss and determine how the value of fixtures and materials should be determined; e.g., at cost in accordance with Regulation 1521, or at retail.

We appreciate the consideration provided to these comments. Please don't hesitate to contact me should you have any questions or comments.

Best regards,



Jesse W. McClellan, Esq.
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Lawrence Duncan III
Vice President
Federal and State Government Relations & PAC Affairs

December 16, 2013

Susanne Buehler, Chief
Board of Equalization
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092

Re: Lockheed Martin Comments for Proposed Regulation 1525.4

Dear Ms. Buehler:

Attached please find Lockheed Martin's comments pertaining to proposed regulation 1525.4, dealing with the sales/use tax exemption for manufacturing and research-and-development equipment.

We are highly appreciative of the effort California is making to craft new economic development legislation and regulation aimed at sustaining and expanding targeted heritage industries in California, such as defense aerospace. While aerospace has long been a core sector of California's high technology economy, the increasing cost of doing business in California combined with substantial industry affordability pressure, has made it increasingly difficult to create a sustainable business model at many California locations. Economic development partnerships, driven by regulation 1525.4 will play a key role in developing a sustainable business case.

At the concept level, our primary concerns with 1525.4 are: it addresses only sales/use tax, is capped at what is reportedly the California incentives ceiling at \$200M; and it is available to a very wide range of NAICS classifications. The risk with a statutory exemption such as this is that it will be distributed so broadly that its impact on targeted industry sectors will be minimized, while its impact on the state economic development budget could be substantial.

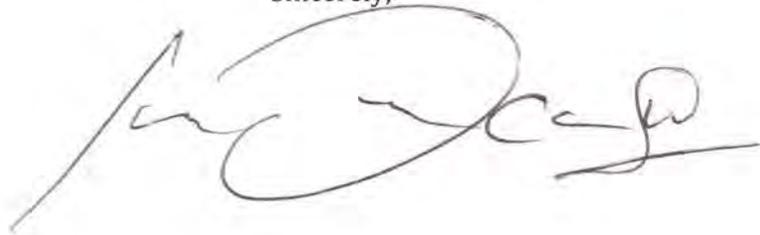
While sales/use tax has an important impact on new aerospace projects where there is a significant new capital investment requirement, it does not address ad valorem tax concerns related to the valuation of existing capital investment, or California's generally high labor COLAs.

Our understanding is that additional legislation is pending to address these key factors, which conceptually, would have a more significant positive impact on heritage defense aerospace businesses than 1525.4.

It is important to ensure that California's economic development budget has a balanced allocation of incentives, directed to targeted industry sectors. While we applaud the introduction of 1525.4, we fear that if it is interpreted too broadly in application, a balanced allocation of incentives may not be possible.

Thank you for considering our views. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to be "Paul D. ...". The signature is written in a cursive style with a large, prominent loop at the beginning.

Proposed California Regulation 1525.4
Lockheed Martin Comments

- 1) 1525.4 (a) 2 - It should be clarified that qualified R&D purchases include prototype hardware and test-bed hardware. The life of these products should be considered to be over the production life of the project (greater than one year), as they contribute to initial research, ongoing product development, training, and industrial engineering applications.
- 2) 1525 (a) 1-4 – Its' not clear that heavy tooling which would become a "fixed monument" attached to a building would be eligible for the incentive.
- 3) 1525 (b) 2 - language is "product ultimately sold at retail". Many aerospace products would never be described as sold at retail. A more generic "final assembled form", would be more inclusive.
- 4) 1525 (b) 6 – Aerospace companies can't generally store their inventory in the building where manufacturing takes place. Production control staging facilities may be in another building on a campus, or at an offsite warehouse. The current definition of Premises does not make it clear that these situations are included. In a JIT inventory system, inventory is sometimes purchased and stored at a vendor, until it is needed on the production line.
- 5) 1525 (b) 8 (A) - At the conceptual level, there appear to be a large amount of NAICS codes applicable. Normally, this type of legislation is limited to those industries the State specifically wants to encourage to stay, grow, or move into the state. This is virtually all the NAICS manufacturing codes. Consider limiting the NAICS eligibility to hold down the cost of the program and ensure a balanced overall economic development structure in the state.
- 6) 1525 (b) 8 (A) 2 - Lockheed Martin exists as one large legal entity, as do a number of other aerospace contractors. It is important that we be allowed to deem a qualified person a line of business or business unit, even though it's not set up as a separate legal entity.
- 7) 1525 (b) 8 (A) 3 – Qualification for the program ought to occur when you make application and it is approved. This paragraph seems to indicate that qualification would be re-evaluated for each year of participation in the program. Qualification should be against the then current NAICS codes (or the successor rating system if NAICS is discontinued).
- 8) 1525 (b) 8 (B) 12 - The current definition of R&D is very broad. It will invite a lot of low end R&D. You might consider using a definition that would restrict participation to high value work.
- 9) In concept, if \$200M is the California total budget for incentives, this program should be limited to something significantly lower than \$200M, to ensure a balanced economic development package for the state as a whole.