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Manufacturing Exemption Goes Into Effect For Reduced Sales and Use Tax in California Beginning July 1, 2014

SUMMARY

Legislation enacted in California in 2013 provides that, beginning July 1, 2014, and extending until June 30, 2022, a “qualified” purchaser or lessee of R&D or manufacturing equipment will be eligible to obtain a partial exemption of the sales and use tax. While the exemption does not apply to the city, county, or district sales taxes, a qualified purchase from July 1, 2014, through December 31, 2016, would receive a reduction in the state sales and use tax rate from 7.5% to 3.3125%. After 2016, the exemption amount is slated to be slightly reduced, resulting in a slight increase in the applicable states sales and use tax rate.

DETAILS

In order to qualify for the exemption, you must be a “qualified” person purchasing “qualified” property which will have a “qualified” use. The exemption is available for qualified businesses classified under specified 2012 North American Industry Classification System codes 3111–3399 (manufacturing), 541711 (biotech research and development), and 541712 (physical, engineering, and life sciences research and development). Businesses in other industries are ineligible for the exemption.

Qualified tax-exempt property could include machinery and equipment; equipment and devices used or required to operate, control, regulate, or maintain the machinery; pollution control items; and certain special purpose buildings and foundations. Qualifying purchases cannot exceed \$200 million in any calendar year per qualified person or combined reporting unit. Please note that the periods of July 1, 2014, through December 31, 2014, and January 1, 2022, through June 30, 2022, are not prorated with respect to the annual limitation.

To qualify for the exemption, the property must be used at least 50 percent in one of the following activities:

- Manufacturing, processing, refining, fabricating, or recycling tangible personal property;
- Researching and developing; or
- Maintaining, repairing, measuring, or testing any qualified property.

Items that do not qualify for the exemption include consumables with a useful life of less than one year, furniture and equipment used to store completed products once the manufacturing process is completed, and property used primarily in administration, general management, or marketing.



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Additionally, the exemption is deemed inapplicable if, within one year from the date of purchase, the purchaser either:

- Uses the property in a manner that does not qualify for the exemption;
- Converts the property from an exempt use to a non-qualifying use; or
- Removes the qualifying property from California.

The California State Board of Equalization (“BOE”) has provided an overview of the exemption, qualifications required for the exemption, and documentation steps to take for both the sellers and purchasers of the “qualified” equipment.¹

The BOE should make available on its Web site in July, 2014, certificates to use for documenting the partial exemption. In the interim, the Web site contains examples of certificates.²

INSIGHTS

Qualified manufacturers and companies performing research and development in the fields of physical, engineering, and life sciences or biotechnology should consider taking the necessary action steps after July 1, 2014, to take advantage of this partial sales and use tax exemption. Estimated savings of \$4,100 on a qualified purchase of \$100,000 should not be ignored. Unless the customer provides an exemption certificate to obtain the reduced rate, sellers of qualifying property should continue to collect the full 7.5% state sales tax rate. The BOE has also provided additional information on the reduced rate in a discussion paper distributed in early 2014.³

GBQ’s sales and use tax team can help provide your company guidance in understanding the qualifications and implementation of this new California exemption.

¹ The document may be viewed at www.boe.ca.gov/sutax/manufacturing_exemptions.htm#Overview.

² The examples may be viewed at www.boe.ca.gov/pdf/boe230m.pdf (for the lease of manufacturing, research, and development equipment) and www.boe.ca.gov/pdf/boe230mc.pdf (construction contracts for manufacturing, research, and development equipment).

³ The discussion paper may be viewed at www.boe.ca.gov/meetings/pdf/1525-4TDPweb.pdf.



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This article originally appeared in BDO USA, LLP's "BDO Knows: SALT" newsletter (June 2014). Copyright © 2014 BDO USA, LLP. All rights reserved. www.bdo.com.

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