KPMG

TaxNewsFlash

United States

No. 2017-309
July 26, 2017

California: Sales and use tax exemption, manufacturing and R&D equipment

California Governor Jerry Brown on July 25, 2017, signed into law Assembly Bill 398 that makes various changes to the state's partial sales and use tax exemption for manufacturing and research and development (R&D) equipment. The legislation also extends California's cap and trade auction program (requiring certain businesses to acquire permits for each ton of greenhouse gases they emit into the environment).

Sales and use tax exemption—background

Under the current law partial exemption, qualifying purchases are exempt from 3.9375 percentage points of the overall sales and use tax. The partial exemption currently applies to purchases of:

- Qualified tangible personal property used primarily (more than 50% of the time) by a qualified person in any stage of 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 the tangible personal property to its completed form, including packaging, if required.

- Qualified tangible personal property purchased by a qualified person to be used primarily in research and development (as defined in IRC section 174 and federal regulations).

- Qualified tangible personal property to be used primarily to maintain, repair, measure, or test any qualified property identified the two bullets above.

- Qualified tangible personal property purchased by a contractor for use in the performance of a construction contract for a qualified person that will use the property as an integral part of the manufacturing, processing, refining, fabricating,

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

Currently, 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). A “qualified person” does not include a business that is required or would be required to use a three-factor evenly weighted apportionment formula (e.g., agricultural businesses, financial corporations and extractive businesses).

Extension, expansion of the partial exemption

The partial exemption was scheduled to expire on July 1, 2022. Assembly Bill 398 extends the life of the exemption through June 30, 2030.

The legislation also extends the partial exemption to various types of power generators, including electric, hydroelectric, fossil fuel, nuclear, solar, wind, geothermal, biomass, and others. The definition of “qualified tangible personal property” is further amended to include property purchased for use by a “qualified person” to be used primarily in the generation or production, or storage and distribution, of electric power. Also, effective January 1, 2018, “qualified tangible personal property” will specifically include special purpose buildings and foundations used as an integral part of the generation, production or storage and distribution of electric power. Currently, only 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 qualifies for the partial exemption.

The legislation also applies to certain agricultural businesses. These entities are no longer specifically excluded from the definition of a “qualified person” and are eligible to qualify for the exemption.

Under current law, equipment eligible for the partial exemption must have a “useful life” of one year or more, and this is generally determined with reference to whether the equipment is treated as a capital expenditure on the taxpayer’s income tax return. Under Assembly Bill 398, taxpayers that deduct certain purchases of qualifying tangible personal property will nevertheless qualify for the exemption.

KPMG observation

The useful life provision appears to be retroactive, and to apply to property that was purchased or leased on or after July 1, 2014, and before January 1, 2018. Taxpayers that have been assessed unpaid tax on such property or have paid tax that was assessed on such property may be entitled to a refund of taxes paid. Taxpayers seeking a cancellation of any assessment or a refund under Assembly Bill 398 must file a request with the new California Department of Tax and Fee Administration by June 30, 2018.

Read a **July 2017 report** [PDF 40 KB] prepared by KPMG LLP

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.