

UC Guidelines – California Partial Sales and Use Tax Exemption

July 21, 2014

I. What change was made to California's Partial Sales and Use Tax Exemption?

Effective from July 01, 2014 through June 30, 2022, California's Partial Sales and Use Tax Exemption includes research and development (R&D) activities under the Board of Equalization's (BOE's) proposed Regulation 1525.4, *Manufacturing and Research & Development Equipment*. The R&D activities must either be in (1) biological sciences (NAICS code 541711), or (2) physical science (NAICS code 541712).

II. What types of Property are “qualified activity”?

A "qualified person" is an organization primarily engaged (50% or more) in a "qualified activity". A “qualified person” may be “primarily engaged” either as a legal entity or as an “establishment” within a legal entity. “Qualified activity” means using “qualified property” primarily (more than 50%) in manufacturing, processing, fabricating, refining or recycling of tangible personal property, as well as research and development, anywhere in California. “Qualified activity” also includes using “qualified property” primarily to maintain, repair, measure, or test any qualified tangible personal property described in the previous sentence. The qualified activity can be found in the business activities described in 2012 North American Industry Classification System (NAICS) codes 3111-3399, or 541711 and 541712.

III. What types of property are “qualified property”?

Qualified property includes machinery and equipment with a useful life **greater than one year** that is used in a “qualified activity”.

Qualified property also includes-

- a. Qualified property that is being leased;
- b. Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures;
- c. Equipment and devices used or required to operate, control, regulate, or maintain the machinery (e.g. computers, data-processing equipment, computer software, etc.) in conjunction with all repair and replacement parts with a useful life of one or more years (even if the equipment and devices are purchased separately or in conjunction with the repair and replacement parts);
- d. Special purpose buildings and foundations including but not limited to clean rooms, climate controlled facilities, wind tunnels, linear accelerators;
- e. Non-depreciable property like leased computers used more than 50% for qualified activities, and catalysts.

Qualified property **does not** include-

- a. Consumables with a useful life of less than one year;
- b. Tangible personal property used primarily for administration, general management, or marketing;
- c. Furniture, inventory, and equipment used in the extraction process; or
- d. Equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process.

UC Guidelines – California Partial Sales and Use Tax Exemption

IV. Does this partial sales and use tax exemption apply to local and district taxes?

No. The partial sales tax exemption is currently 4.1875%. The current statewide sales tax rate is 7.50%, so a partial sales tax reduction of 4.1875% will result in a 3.3125% sales tax rate (7.50% current statewide rate – 4.1875% partial exemption), plus any applicable local and district sales taxes.

V. How much is exempt from California’s sales and use tax each calendar year under the new R&D rules?

Up to \$200 million per calendar year in qualifying purchases made by a single taxpayer or reporting unit is exempt from California’s sales and use taxes. For calendar year 2014, the full \$200 million is exempt (not prorated), even though the exemption only occurs from July 01, 2014 through December 31, 2014. Please note that any amounts unused will **not** carry forward to future years.

VI. Can the University use the Partial Exemption for R&D?

Yes. As long as the “qualified property” is used in California for R&D purposes in either biological sciences or physical sciences for first 12 months of the qualified property’s use, the partial exemption for R&D may apply to the UC, specifically to Departments or other establishments engaged in qualifying R&D activities.

VII. Is the \$200 million annual limit for each campus?

Currently, no. The \$200 million annual limit will only apply to the University system-wide.

However, the University is looking into obtaining formal written guidance from the BOE to clarify if this annual limit applies for each campus or only the University system-wide. If the BOE rules that this annual limit applies to each campus, then a refund can be requested.

VIII. What must the University system do to keep track of this exemption?

Keeping track of this exemption is important because the University system will be held liable for the full sales tax amount on purchases exceeding the \$200 million exemption limit. Some implementation considerations include developing accounting and tracking systems. Analysis may be required to determine if a fund on award may qualify as an “establishment”.

Establishments are locations or combinations of locations designated as a “cost center” or “economic unit” by the campus where a qualified activity is performed and for which the campus maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining to the qualified activity.

UC Guidelines – California Partial Sales and Use Tax Exemption

The “cost center” is important because establishment has to show any one of the following:

- i. Person derives 50% or more gross receipts from qualified activities;
- ii. Person expends 50% or more of operating expenses in qualified activities; or
- iii. For UC, 50% or more of a campus’s qualified activity.

Campuses may have “establishments” that do “qualified activities” that are manufacturing activities (e.g. printing and circulation). Even though the University may not have the NAICS Code for manufacturing or R&D, its “establishments” may qualify under the manufacturing or R&D NAICS Codes.

IX. What if campuses share ownership of qualified property with other parties (including other campuses)?

Each cost center must determine how much of the qualified property should be allocated to each party based on use. It is important to make sure that the partial sales and use tax exemption is not over claimed.

X. Does the University have to issue exemption certificates to its vendors?

Yes. There are two types of exemption certificates provided by the BOE, depending on the services provided.

For equipment and machinery purchases, the campus must provide the vendor with an exemption certificate for equipment ([BOE-230-M](#)). For special purpose buildings and foundations built by construction contractors, the University must provide the construction contractors with an exemption certificate for construction contracts ([BOE-230-MC](#)).

These partial exemption certificates must contain the following:

- the signature of the purchaser, the purchaser’s agent, or the purchaser’s employee;
- the name, address, and telephone number of the purchaser
- the purchaser’s seller’s permit number, or if the purchaser is not required to hold a seller’s permit, a notation to that effect and the reason;
- a description of the property purchased; and
- the date of execution of the document.

Please see **Appendix A** for an example of BOE-230-M (exemption certificate for equipment) and **Appendix B** for an example of BOE-230-MC (exemption certificate for construction contracts). In both examples, John Smith is the Procurement Manager who will sign the exemption certificates for the fictional University of California, Campus A. UC Campus A’s seller’s permit number is 12345. The use of the qualified properties begins August 01, 2014 (date of execution).

UC Guidelines – California Partial Sales and Use Tax Exemption

XI. If an exemption for qualified property was not previously claimed, can the University system file for a refund?

As long as the University system did not use its entire \$200 million exemption for the year in which a qualified property sales or use tax exemption was not claimed, then an individual campus can still file for a refund for any remaining qualifying purchases within the \$200 million cap. The statute of limitations for refunds is 3 years after the filing date.

For example, assume Campus A placed equipment worth \$15 million that is qualified property into service on August 01, 2014 but did not claim the sales tax exemption. In 2016, Campus A realized it did not claim the exemption on the equipment and will file for a refund on the state sales tax during 2016. The UC System had used \$190 million of the 2014 \$200 million exemption. Campus A can file for a refund for the sales tax charged on only \$10 million of the equipment instead of the entire \$15 million. The reason is because Campus A had already claimed state sales tax exemption on \$190 million worth of qualified property in 2014, which left Campus A with only \$10 million that it did not claim the sales tax credit on.

XII. If you do not know whether you will meet the partial sales tax exemption requirements at the time of purchase, can the University system still issue a partial exemption certificate?

If the campus anticipates that the partial exemption requirements will be met within one year after the purchase date, a partial exemption certificate may be issued. However, if the requirements are not met within that one year period, the University system will be liable for the unpaid sales tax, including applicable interest for unpaid sales taxes.

XIII. Key Terms and Definitions

A. Qualified activities

1. Business activities described in 2012 North American Industry Classification System (NAICS) codes 3111-3399, or 541711 and 541712

B. Qualified person

1. An organization primarily engaged (50% or more) in a qualified activity described in 2012 NAICS codes 3111-3399, or 541711 and 541712
2. A “qualified person” may be “primarily engaged” either as a legal entity or as an “establishment” within a legal entity

C. Manufacturing

1. NAICS codes 3111-3399 are the general manufacturing codes
2. A qualified person will not be precluded from qualifying when there is no six digit NAICS code to describe their business, provided their business activities are described in a qualified 4 digit industry group

D. Research and development in biotechnology, physical engineering, and life sciences

1. NAICS code 541711, Biotechnology and other life science research
2. NAICS code 541712, Research and development categorized by industry (i.e., agriculture, biology, botany, chemical, guided missile and space vehicles, industrial)

UC Guidelines – California Partial Sales and Use Tax Exemption

E. Qualified property

1. Includes machinery and equipment with a useful life greater than one year, used “primarily” (more than 50%) in manufacturing, processing, fabricating, refining or recycling of tangible personal property, as well as research and development, anywhere in California
2. Qualified property also includes
 - a. Qualified property that is being leased
 - b. Special purpose buildings and foundations including but not limited to clean rooms, climate controlled facilities, wind tunnels, linear accelerators
 - c. Non-depreciable property like leased computers used more than 50% for qualified activities, and catalysts

F. Establishment

1. Multiple or single physical locations (including any portion or portions thereof)
2. Locations or combinations of locations designated as a “cost center” or “economic unit” by the University where a qualified activity is performed and for which the University maintains separate books and records that reflect revenue, costs, number of employees, wages or salaries, property and equipment, job costing, or other financial data pertaining the qualified activity
 - a. “Cost center” important because establishment has to show any one of the following:
 - i. Person derives 50% or more gross receipts from qualified activities;
 - ii. Person expends 50% or more of operating expenses in qualified activities; or
 - iii. For UC, 50% or more of UC’s qualified activity
3. Campuses may have “establishments” that do “qualified activities” that are manufacturing (e.g. printing and circulation)
 - a. **Key Lesson:** just because the UC may not have the NAICS Code, its “establishments” may qualify under other NAICS Codes

BOE-230-M (5-14)
PARTIAL EXEMPTION CERTIFICATE FOR
MANUFACTURING, RESEARCH AND DEVELOPMENT EQUIPMENTSection 6377.1¹

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 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

Test Tube, Inc.

SELLER'S/LESSOR'S ADDRESS (street, city, state, zip code)

123 Test Center Street, Springfield, CA 98765

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

1. for manufacturing, processing, refining, fabricating, or recycling;
2. for research and development;
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 personal property purchased or leased²

Test tubes to research how new chemical compounds interact.

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.

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 in the North American Industry Classification System (NAICS)³ 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 by law, I am required to report and pay the state tax (calculated on the sales price/rentals payable of the property) at the time the property is purchased, removed, converted, or used if:

- the purchase exceeds the \$200 million limitation;
- the property is removed from California within one year of the date of purchase or lease;
- the property is converted for use in a manner not qualifying for the exemption; or
- the property is used in a manner not qualifying for the partial exemption.

NAME OF PURCHASER University of California, Campus A	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING John Smith	TITLE Procurement Manager
ADDRESS OF PURCHASER 1234 Kerr Drive, Springfield, CA 98765	
PERMIT NUMBER (if you are not required to hold a permit, explain why) 12345	TELEPHONE NUMBER (123) 456-7890
EMAIL ADDRESS OF PERSON SIGNING john.smith@campusa.edu	DATE August 01, 2014

¹The Sales and Use Tax Department is making this sample form available for industry's use. However, please note that the Board of Equalization (BOE) is prescribing the form of the certificate as part of Regulation 1525.4, which is pending adoption by the BOE and approval by the Office of Administrative Law. Until the regulation is adopted and approved, the form is subject to change.

² See Regulation 1525.4 (b) (9) for a description of what is included and excluded from "qualified tangible personal property."

³ Official 2012 US NA/CS Manual, U.S. Office of Management and Budget, 2012 edition.

BOE-230-MC (5-14)

CONSTRUCTION CONTRACTS-PARTIAL EXEMPTION CERTIFICATE FOR MANUFACTURING, RESEARCH AND DEVELOPMENT EQUIPMENT**Section 6377.1¹**

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 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

Building Contractor, Inc.

SELLER'S/LESSOR'S ADDRESS (street, city, state, zip code)

987 Contractor Avenue, Springfield, CA 98765

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 personal property purchased²

Clean room building for biomedical research.

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.

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 in the North American Industry Classification System (NAICS)³ 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 University of California, Campus A	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING John Smith	TITLE Procurement Manager
ADDRESS OF PURCHASER 1234 Kerr Drive, Springfield, CA 98765	
PERMIT NUMBER <i>if you are not required to hold a permit, explain why</i> 12345	TELEPHONE NUMBER (123) 456-7890
EMAIL ADDRESS OF PERSON SIGNING john.smith@campusa.edu	DATE August 01, 2014

¹The Sales and Use Tax Department is making this sample form available for Industry's use. However, please note that the Board of Equalization (BOE) is prescribing the form of the certificate as part of Regulation 1525.4, which is pending adoption by the BOE and approval by the Office of Administrative Law. Until the regulation is adopted and approved, the form is subject to change.

²See Regulation 1525.4 (b)(9) for a description of what is included and excluded from "qualified tangible personal property."

³Official/ 2012 US NA/CS Manual, U.S. Office of Management and Budget, 2012 edition.

DRAFT

DRAFT