

## California Enacts Partial Sales and Use Tax Exemption Potentially Worth More than \$8 Million Annually to Certain Life Science Companies

September 17, 2013

### Overview

On July 11, 2013, California Governor Edmund G. Brown Jr. signed Assembly Bill (“AB”) 93 and Senate Bill (“SB”) 90, enacting, among other provisions, a significant new tax incentive that is potentially worth more than \$8 million annually to certain companies in the life science industry.<sup>1</sup> The new tax incentive is a partial exemption from state-level sales and use tax (specifically 4.1875%) for purchases of qualified property used in certain manufacturing and research and development activities. This new partial exemption is effective for sales or use tax imposed on or after July 1, 2014.<sup>2</sup> In this tax alert we summarize this exemption and provide observations regarding its application.

### Summary of New Partial Sales and Use Tax Exemption

The new exemption applies to purchases of “qualified tangible personal property” (“qualified TPP”) made by a “qualified person.”<sup>3</sup> A “qualified person” is defined as a person primarily engaged (meaning 50% or more of the time) in activities described in codes 3111-3399, 541711 and 541712 of the 2012 North American Industry Classification System (“NAICS”).<sup>4</sup>

NAICS codes 3111-3399 describe a large portion of the manufacturing sector, including many life science business activities such as pharmaceutical and medicine manufacturing (NAICS code 3254), lab instrument manufacturing (NAICS code 3345) and medical equipment and supplies manufacturing (NAICS code 3391). Separately, NAICS codes 541711 and 541712 describe research and development in biotechnology and life sciences, respectively.

*Observation:* Companies that conduct both qualified and non-qualified activities will need to identify whether they are primarily engaged in a qualified activity. For example, a company that manufactures pharmaceuticals (NAICS code 3254) but also acts as a drug wholesaler (NAICS code 4242, not a qualified activity) will need to determine its primary activity. It is not clear under the current statute how the “50% or more of the time” rule will be specifically measured, although it appears measurement may be applied separately for each legal entity.

“Qualified TPP” includes machinery and equipment and certain other items of TPP purchased by a qualified person for use “primarily” (meaning 50% or more of the time) in any stage of manufacturing or research and development, or used primarily to maintain, repair, measure or test property used in manufacturing or research and development.<sup>5</sup> Qualified TPP also includes special purpose buildings and foundations used as an integral part of the manufacturing process,<sup>6</sup> and purchases made on behalf of a qualified person by a construction contractor.<sup>7</sup> The exemption also applies to

<sup>1</sup> Stats 2013 ch 69 (AB 93), effective July 11, 2013; Stats 2013 ch 70 (SB 90), effective July 11, 2013. In addition to the new partial sales tax exemption, AB 93 and SB 90 phase out California’s Enterprise Zone tax credit program, establish a new hiring credit, and create a negotiated incentive fund to attract and retain new business in California. For a broader summary of the provisions contained in AB 93 and SB 90, please see our External Tax Alert dated July 9, 2013, accessible at:

[http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us\\_tax\\_multistate\\_CA\\_070913.pdf](http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_multistate_CA_070913.pdf).

<sup>2</sup> Cal. Rev. & Tax. Code § 6377.1(a).

<sup>3</sup> *Id.*

<sup>4</sup> Cal. Rev. & Tax. Code § 6377.1(b)(6)(A).

<sup>5</sup> Cal. Rev. & Tax. Code §§ 6377.1(b)(7) and 6377.1(a).

<sup>6</sup> Cal. Rev. & Tax. Code § 6377.1(b)(7)(A)(iv).

<sup>7</sup> Cal. Rev. & Tax. Code § 6377.1(a)(4).

leases of qualified property if the leases are considered “continuing sales” and “continuing purchases” under existing sales tax law.<sup>8</sup>

The exemption applies to the first \$200 million in qualified purchases for each taxpayer annually, which at a 4.1875% exemption rate equates to more than \$8 million in potential savings.<sup>9</sup> If a taxpayer is part of a combined group for California franchise tax purposes, the \$200 million limitation applies to the entire combined group.<sup>10</sup>

*Observation:* A significant part of preparing for this new sales tax exemption will be identifying qualified property and creating systems and processes to contemporaneously claim the exemption. Additionally, companies, including those filing combined California franchise tax returns, will need to establish systems to track qualified purchases so as not to exceed the \$200 million annual limitation.

*Observation:* In light of the July 1, 2014 effective date, companies should consider the timing of their capital spend for otherwise qualified purchases anticipated to close prior to that date.

## Contacts

If you have questions regarding the matters discussed in this Alert, please contact any of the following Deloitte Tax Multistate professionals:

Hal Kessler  
Director  
Deloitte Tax LLP, San Francisco  
[hkessler@deloitte.com](mailto:hkessler@deloitte.com)  
(415) 783-6368

Tony Pollock  
Director  
Deloitte Tax LLP, San Diego  
[tonypollock@deloitte.com](mailto:tonypollock@deloitte.com)  
(619) 237-6516

Dennis Fox  
Senior Manager  
Deloitte Tax LLP, Costa Mesa  
[defox@deloitte.com](mailto:defox@deloitte.com)  
(714) 436-7860

Karri Rozario  
Senior Manager  
Deloitte Tax LLP, Sacramento  
[krozario@deloitte.com](mailto:krozario@deloitte.com)  
(916) 288-3246

**This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.**

### About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2013 Deloitte Development LLC. All rights reserved.  
Member of Deloitte Touche Tohmatsu Limited

<sup>8</sup> Cal. Rev. & Tax. Code § 6377.1(f).

<sup>9</sup> Cal. Rev. & Tax. Code § 6377.1(e)(1)(A).

<sup>10</sup> *Id.*