

UC Guidelines – California Partial Sales and Use Tax Exemption

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

Effective from July 01, 2014 through June 30, 2030, California's Partial Sales and Use Tax Exemption includes research and development (R&D) activities under the California Department of Tax and Fee Administration's (CDTFA's) Cal. Rev. & Tax. Cd. § 6377.1 and 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). Please note that the NAICS codes refer to the activities described in the 2012 edition.

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, research and development, and generating, producing, storing, or distributing electric power, 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.
- f. Depreciable property used to generate, produce, store or distribute electric power.

Qualified property **does not** include-

- a. Consumables with a useful life of less than one year;

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- b. Tangible personal property of less than \$5,000 that is expensed immediately rather than depreciated over more than one year;
- c. Tangible personal property used primarily for administration, general management, or marketing;
- d. Furniture, inventory, and equipment used in the extraction process; or
- e. Equipment used to store finished products that have completed the manufacturing, processing, refining, fabricating, or recycling process.

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

No. Effective from January 01, 2017 to June 30, 2030, the partial exemption is now 3.9375% (Cal. Code Regs. 1525.4). And Proposition 30, *Temporary Taxes to Fund Education*, expired after December 31, 2016, which resulted in the reduction of California's state portion of sales tax to 7.25% (from 7.50%). So a partial sales tax reduction of 3.9375% that started on January 01, 2017 will continue to result in the sales tax rate of 3.3125% (7.25% post-Prop 30 statewide rate - 3.9375% 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?

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

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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 the qualified activity.

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.

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. The campus must provide an exemption certificate ([CDTFA-230-M](#)) to-

- a. the vendors of equipment and machinery, and
- b. the construction contractors and subcontractors of special purpose buildings and foundations.

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;
- the purchase order or sales invoice number in the description of qualified personal property purchase or leased;
- a description of the property purchased in the description of qualified personal property purchase or leased; and
- the date of execution of the document.

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Please see **Appendix A** for an example of CDTFA-230-M (exemption certificate for equipment). In the example, 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 begin January 31, 2018 (date of execution). The purchase order number is 01-234.

XI. For the construction of special purpose buildings, should the University have separate contracts with the contractors and subcontractors?

Yes. When the University gives the contractors and subcontractors the exemption certificate ([CDTFA-230-M](#)), the exemption certificate indicates that the partial sales tax exemption for the materials and fixtures installed in the special purposes buildings belongs to the University and counts toward the University's annual cap. The contractors and subcontracts provide a different exemption certificate to their vendors indicating that the materials and fixtures will be installed in special purpose buildings that have a partial sales tax exemption, but the exemption still belongs to the University.

Thus, the University should have separate contracts with the different contractors and subcontractors to keep track of the materials and fixtures that count toward the University's annual \$200 million partial sales tax exemption cap.

XII. For the construction of special purpose buildings, how should the partial sales tax savings be passed on to the University?

The savings from the partial sales tax exemption should be built into the contract between the University and the contractors & subcontractors.

XIII. If special purpose buildings require more than one year to build, how should the Partial Sales Tax Exemption be allocated in different years for the University's \$200 million cap?

The allocation of the partial sales tax exemption depends on when the contractors and subcontractors depends on when the materials and fixtures are installed, not when the contractors and subcontractors purchase the materials and fixtures with the partial sales tax exemption.

For example, assume a contractor begins work on a special purpose building in November 2017 and finishes in July 2018. The special purpose building has \$1,000,000 in materials and fixtures that the contractor obtained a partial sales tax exemption for the University. The contractor purchases \$800,000 of the exempted materials and fixtures in 2017 and the other \$200,000 in 2018, but the contractor installs \$400,000 of the exempted materials and fixtures in the building in 2017 and the other \$600,000 in 2018. Because of the requirement that the exemption depends on when the contractors install the materials and fixtures to the special purpose building, the

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2017 cap will apply to the \$400,000 of exempted materials and fixtures installed in 2017, and the 2018 cap will apply to the other \$600,000 of exempted materials and fixtures installed in 2018.

XIV. If an exemption for qualified property was not previously claimed, can the University system seek 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. Please note that sales tax refunds must be claimed with the vendors and use tax refunds/credits must be claimed on

For example, assume Campus A placed equipment worth \$15 million that is qualified property into service on August 01, 2016 but did not claim the sales tax exemption. In 2018, Campus A realized it did not claim the exemption on the equipment and will file for a refund on the state sales tax during 2018. The UC System had used \$190 million of the 2016 \$200 million exemption. Campus A can request that the vendor file for a refund on behalf of the campus of 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 2016, which left Campus A with only \$10 million that it did not claim the sales tax credit on.

XV. 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.

XVI. 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 221111 to 221118, 221122, 541711 and 541712
2. A “qualified person” may be “primarily engaged” either as a legal entity or as an “establishment” within a legal entity

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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)

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

**PARTIAL EXEMPTION CERTIFICATE FOR
MANUFACTURING, RESEARCH AND DEVELOPMENT EQUIPMENT**UC Berkeley
Substitute CDTFA-230-M**Section 6377.1**

This is a partial exemption from sales and use taxes at the rate of 4.1875 percent from July 1, 2014, to December 31, 2016, and at the rate of 3.9375 percent 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;
2. for research and development; REQUIRED - Provide sponsored research award's chartfield value (7 digits):
3. to maintain, repair, measure, or test any property being used for (1) or (2) above; **or** as a special purpose
4. building and/or foundation.

If qualified property will be used for research and development (box 2 checked above), please check the box that best applies:

- Biotechnology Research and Development
- Physical Research and Development
- Engineering Research and Development
- Life Sciences Research and Development
- Engaged in manufacturing, processing, refining, fabricating, or recycling

Description of qualified tangible personal property purchased or leased:¹

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)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 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 converted for use in a manner not qualifying for the exemption
- the property is removed from California within one year of the date of purchase or lease
- the property is used in a manner not qualifying for the partial exemption

NAME OF PURCHASER University of California, Berkeley	SIGNATURE OF PURCHASER, PURCHASER'S EMPLOYEE, OR AUTHORIZED REPRESENTATIVE
PRINTED NAME OF PERSON SIGNING	TITLE
ADDRESS OF PURCHASER	DEPARTMENT OF PURCHASER
PERMIT NUMBER (if you are not required to hold a permit, explain why) SR-CH-21-135302	TELEPHONE NUMBER ()
EMAIL ADDRESS OF PERSON SIGNING	DATE

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

² Official 2012 US NAICS Manual, U.S. Office of Management and Budget, 2012 edition.