



STATE BOARD OF EQUALIZATION

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December 15, 1995

Ms. S--- L--- G---
--- --- L.L.P.
--- --- Tower
Suite XXXX
--- ---
--- ---, California XXXXX-XXXX

Re: M--- I--- of California
Account No. SY --- XX-XXXXXX

Dear Ms. G---:

This is in response to your letter dated August 4, 1995, requesting our opinion with regard to whether or not M--- I--- of California qualifies as a "new trade or business" pursuant to Revenue and Taxation Code section 6377(b)(5)(A)¹ and Sales and Use Tax Regulation section 1525.2. For purposes of this opinion, we assume that the taxpayer meets and qualifies under all other provisions of section 6377 and Regulation section 1525.2.

Before answering your specific request, a brief overview of the section 6377 partial sales and use tax exemption (hereinafter referred to as the "partial sales and use tax exemption") is necessary to facilitate our response. The partial sales and use tax exemption generally applies to persons who commence a new trade or business (discussed below) on or after January 1, 1994, inside this state which is described in codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual (hereinafter "SIC code"). A person meeting these requirements is a "qualified person"; however, a qualified person does not include a person who undertakes a manufacturing activity inside this state within the same SIC code division as a prior trade or business operated by that person (or any related person within the meaning of sections 267 and 318 of the Internal Revenue Code) inside this state within the previous 36 months. The partial sales and use tax exemption generally applies to the sale or use of tangible personal property used primarily for manufacturing, processing, refining, fabricating, recycling, research and development and the repair of qualified property.

¹All further references are to the Revenue and Taxation Code unless otherwise noted.

A new trade or business is a trade business which a person (or any related person) has not engaged in within the preceding 36 months inside this state² or which is classified in a different division of the SIC code than that person's (or any related person's) current or prior trade or business activities in this state. (Rev. & Tax. Code § 6377(b)(5)(A)(ii).) In addition, a new trade or business must commence such operations inside this state on or after January 1, 1994. (Reg. 1525.2(c)(5)(A).) Generally, business operations begin upon the acquisition of operating assets that are necessary to the type of business contemplated. (See Reg. 1525.2(c)(5)(A)1.)

“New trade or business” status is even more limited in situations where a person acquires the assets of another business. (Rev. & Tax. Code § 6377(b)(5)(A)(i).) Under such circumstances, the trade or business conducted by the acquiring person (or any related person) after acquisition of the assets shall **not** be treated as a new trade or business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by that person (or any related person) in the conduct of his or her trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business conducted by that person (or any related person). (Rev. & Tax. Code § 6377(b)(5)(A)(i).)

We understand from your letter that you do not dispute that the taxpayer and its “sister” corporations A, B, C, and D are “related persons” within the meaning of Internal Revenue Code sections 267 and 318. We also understand from your letter that taxpayer meets the 20 percent test set forth in section 6377(b)(5)(A)(i) and that corporations A and D were previously engaged in some form of business operations inside this state within the previous 36 months. This being the case, the taxpayer will qualify as a “new trade or business” only if it meets the following provisions of section 6377(b)(5)(A)(i):

“In any case where a person (ore related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (‘prior trade or business activity’), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the person's (or any related person's) current or prior trade or business activities in this state.”

²Section 6377 makes a distinction between persons engaged in a trade or business inside the state and those that are not. Persons engaged in business wholly outside the state who commence doing business in California on or after January 1, 1994, qualify as a new trade or business regardless of any prior trade or business activity. (See Rev. & Tax. Code § 6377(b)(5)(A)(iii).)

In other words, the taxpayer must not be regarded as having engaged in a manufacturing activity inside this state within the 36 months preceding the time it engaged in manufacturing operations through the assets it purchased from the S--- J--- P--- Company (“SJPC”). (See also Reg. 1525.2(c)(5)(A)(4).) We have therefore analyzed each of the operations of corporations A and D below for purposes of determining whether or not the taxpayer is regarded as having undertaken a manufacturing operation inside this state within the previous 36 months.

Corporation A Activity

You state that corporation A is engaged in a manufacturing operation outside this state but that it previously maintained a salesperson(s) as an employee in California for the purpose of soliciting orders. Under an earlier draft of Regulation 1525.2(c)(5)(A)3, a person was regarded as having conducted a manufacturing operation inside this state if it merely operated a warehouse or sales office inside this state for its out-of-state manufacturing operation.³ Language reflecting this position was not, however, adopted by the Board in the final version of Regulation 1525.2(c)(5)(A)3⁴ and, therefore, is not a condition for qualifying as a new trade or business. Thus, a person is regarded as having undertaken a manufacturing operation in California only if it actually engaged in a business operation described in SIC codes 2000 to 3999 inside this state.

We understand that corporation A only maintained a sales employee inside California. We assume that the operations of this sales representative fell within the non-manufacturing SIC division F,⁵ “Wholesale trade” (durable and non-durable goods), involving the wholesale distribution of durable and non-durable goods. “And, in addition, we assume that this California sales “unit” constitutes a separately-located auxiliary sales unit that is to be treated as a separate non-manufacturing establishment. As such, corporation A’s activities inside this state do not constitute a manufacturing operation by the taxpayer. This means that the taxpayer is not

³An earlier draft of Regulation 1525.2(c)(5)(A)3 contained the following additional language:

“A manufacturer may be considered to have conducted activities in a manufacturing trade or business in this state even if that manufacturer has never operated a manufacturing plant here, but, instead, has only operated a warehouse or sales office in this state.”

⁴The final adopted version of Regulation 1525.2(c)(5)(A)3 reads:

“A trade or business is not a new trade or business in this state if, within the 36 months preceding the date that activities were first commenced in that trade or business in this state, either the person claiming the partial exemption, or any related person, had conducted any activities in this state in any trade or business classified under the same division of the Manual as that trade or business.”

⁵Division F contains SIC codes 5012 through 5199.

precluded from qualifying as a “new trade or business” based on the past sales operations of corporation A inside this state.

Corporation D Activity

M--- P--- S---, Inc.’s (corporation D) application for a use tax account with the Board states that it will sell “Packaging Equip, Parts + Service” and lists “service/repair” and “retail” as a description of its business. You further state that corporation D lists “Miscellaneous services” on its franchise tax return, Form 100. We therefore assume that corporation D has not been (nor has ever been) engaged in a manufacturing operation inside this state as defined in SIC codes 2000 to 3999 within the previous 36 months. (If this assumption is incorrect, our opinion would be different.) This means that the taxpayer is not precluded from qualifying as a “new trade or business” based upon the present or past operations of corporation D inside this state.

* * * * *

This letter is based upon the facts and representations set forth in your letter, and the assumptions reflected herein. If the actual facts and circumstances differ from those set forth in your letter, then our opinion likewise might be different. If you have any further questions, please write again.

Sincerely,

Robert W. Lambert
Senior Staff Counsel

RWL/cmm

cc: Mr. Dennis Fox (MIC:92)
Mr. Mike Hilbert (MIC:40)
Mr. Warren L. Astleford (MIC:82)