Date of Hearing: June 30, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

SB 587 (Grayson) – As Amended May 23, 2025

Majority vote. Tax levy. Fiscal committee.

SENATE VOTE: 38-0

SUBJECT: Personal income taxes: credit: manufacturing: sales and use taxes

SUMMARY: Allows a credit under both the Personal Income Tax (PIT) Law and the Corporation Tax (CT) Law equal to the amount of sales tax reimbursement or use tax paid on purchases that were partially exempt under the existing sales and use tax (SUT) exemption for manufacturing and research and development (MR&D). Specifically, **this bill**:

1) Allows, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, a credit equal to "qualified tax payments" made during the taxable year.

2) Defines a "qualified tax payment" as a tax payment made to the extent that the purchase, or the storage, use, or other consumption in this state, of tangible personal property (TPP) would have been exempt from tax pursuant to Revenue and Taxation Code (R&TC) Section 6377.1 if not for the applicable of subdivision (d) of that section.

3) Defines a "tax payment" to mean either of the following:

   a) A sales tax reimbursement paid by the taxpayer to a retailer, as reimbursement for a tax imposed by the sales tax, or pursuant to a local ordinance authorized by the Bradley-Burns Uniform Local SUT Law or the Transactions and Use Tax (TUT) Law; or,

   b) Use taxes paid by the taxpayer pursuant to the use tax, or pursuant to a local ordinance authorized by the Bradley-Burns Uniform Local SUT Law or the TUT Law.

4) Provides that any deduction otherwise allowed for any amount paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit allowed.

5) Provides that, if the credit amount exceeds the taxpayer's tax liability, the excess credit amount may be carried over to reduce the taxpayer's tax liability in the following taxable year, and succeeding eight years, if necessary, until the credit is exhausted.

6) Provides that the credit may be claimed only on a timely filed original return of a taxpayer.

7) Provides that a credit, or the carryover of a credit, shall not be allowed with respect to TPP described in R&TC Section 6377.1(e)(1)(B), which describes TPP removed from California.

8) Provides that, in cases where the TPP that is subject to the tax giving rise to the credit is subsequently moved out of state or is otherwise described in R&TC Section 6377.1(e)(1)(B) within one year from the date of purchase, the taxpayer shall file an amended return for the taxable year in which the credit was claimed.

9) Authorizes the Franchise Tax Board (FTB) to request any information necessary for the administration of this credit from the California Department of Tax and Fee Administration (CDTFA).

10) Provides that notwithstanding R&TC Section 7056, the CDTFA may provide information to the FTB, in a form and manner agreed upon between the CDTFA and the FTB, necessary for the administration of the credit program. Any taxpayer information provided by the CDTFA to the FTB shall be subject to the provisions of R&TC Section 7056.5.

11) Authorizes the FTB to prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this credit program. The Administrative Procedure Act shall not apply to any rule, guideline, or procedure prescribed by the FTB pursuant to this bill.

12) Authorizes the FTB to prescribe any regulations necessary or appropriate to carry out the purposes of this bill, including any regulations to prevent improper claims from being filed.

13) Provides that on or before May 14, 2026, and annually thereafter, the Department of Finance shall provide to the legislative budget committees an estimate of the amount of revenue that would not be realized if the credits established by this bill were allowed for that taxable year.

14) Provides that the credits established by this bill shall be allowed only for taxable years for which the Legislature appropriates money in the Budget Act for the administration of the credit program.

15) Provides that, for purposes of complying with R&TC Section 41, the Legislature finds and declares the following:

    a) The specific goal that the credits will achieve is to encourage new and continued investment in California in the areas of MR&D; and,

    b) Detailed performance indicators for the Legislature to use in determining whether the credits meet that goal are as follows:

        i) The total dollar amount of tax credits allowed; and,

        ii) The number of taxpayers that were allowed a tax credit.

16) Provides that, on or before April 1, 2033, the FTB shall submit a report to the Legislature, in compliance with R&TC Section 9795, detailing the total dollar amount of tax credits allowed pursuant to this bill, and the number of taxpayers allowed a credit.

17) Provides that no reimbursement is required by this bill pursuant to Section 6 of Article XIII B of the California Constitution for specified reasons.

18) Takes immediate effect as a tax levy.

19) Sunsets the credit provisions on December 1, 2031.

EXISTING LAW:

1) Allows various tax credits under both the PIT Law and CT Law. These credits are generally designed to encourage socially beneficial behavior or to provide relief to taxpayers who incur specified expenses. (R&TC Sections 17001 *et seq.* and 23001 *et seq*.)

2) Imposes, under the SUT Law, a tax on retailers measured by the gross receipts from the sale of TPP sold at retail in this state or on the storage, use, or other consumption in this state of TPP purchased from a retailer for storage, use, or other consumption in this state. (R&TC Section 6001 *et seq.*)

3) Provides, until July 1, 2030, a partial MR&D SUT exemption for qualified TPP purchased for use by a qualified person to be used primarily:

   a) In any stage of the manufacturing, processing, refining, fabricating, or recycling of TPP;

   b) In research and development;

   c) To maintain, repair, measure, or test any qualified TPP described above; and,

   d) In the generation or production, or storage and distribution, of electric power.

   The partial exemption also applies to qualified TPP purchased for use by a contractor to perform a construction contract for a qualified person that will use that property as an integral part of the following:

   a) The manufacturing, processing, refining, fabricating, or recycling process;

   b) The generation or production, or storage and distribution, of electric power; or,

   c) As a research or storage facility for use in connection with those processes. (R&TC Section 6377.1.)

4) Requires any bill that authorizes a tax expenditure to contain all of the following:

   a) Specific goals, purposes, and objectives that the tax expenditure will achieve;

   b) Detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets the goals, purposes, and objectives stated in the bill; and,

   c) Specified data collection requirements to enable the Legislature to determine whether the tax expenditure is meeting, failing to meet, or exceeding those specific goals, purposes, and objectives. (R&TC Section 41.)

FISCAL EFFECT: The FTB estimates that this bill would reduce General Fund revenues by $50 million in fiscal year (FY) 2025-26, by $210 million in FY 2026-27, and by $330 million in FY 2027-28.

COMMENTS:

1) The author has provided the following statement in support of this bill:

> Within the California economy, manufacturing plays a crucial and essential role, supporting high wage jobs and small businesses. California has comparative manufacturing advantages to other regions of the world due to the strength and depth of its innovation in technology. Not only does manufacturing employ 1.1 million people in California, but it also plays a key role in creating new jobs with its multiplier effect, supporting 2.5 jobs for every one manufacturing job. It is also important to note that the average annual earnings for employees in the manufacturing sector is $171,665. In 2021, manufacturing in California contributed significantly to the state's exports, and represented 11.00 % ($300 billion in goods) of California's GDP.
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> There is a large misconception that all manufacturing is done on large industrial scales, however over 70% of manufacturers have less than 20 employees. Prior to the pandemic, California manufacturing had already faced a decline in total employment. Many of these losses are a result of California's steep cost of doing business, which is one of the highest in the nation. Other states are aggressively attempting to lure California manufacturers with lower business costs and location incentives.
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> According to the 2024 California Jobs Market Briefing published by the Employment Development Department (EDD), the manufacturing sector was one of only three industries that experienced job loss. It is therefore imperative that the state find ways to mitigate financial burdens and promote increased production and ensure the growth of high-wage jobs for a variety of skill levels and backgrounds in one of the state's essential industries. A stout manufacturing job base is key to the global and domestic competitiveness of our economy. SB 587 will help strengthen that job base.

2) This bill is supported by the California Manufacturers & Technology Association, which notes the following:

> California's manufacturing sector generates over $300 billion annually and employs more than 1.3 million people. However, while the base state sales tax rate is 6 percent, the local portions of the sales tax (Bradley-[Burns] local sales tax) can reach up to 10.75 percent, making it increasingly difficult for manufacturers to remain competitive, particularly when investing in new equipment and technology. SB 587 addresses this issue by allowing businesses to offset the local sales tax burden on equipment purchases, leveling the playing field and encouraging businesses to invest in California, instead of seeking more favorable tax environments in the other 38 states that already cover the taxes on qualified manufacturing purchases.
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> SB 587 supports a wide range of industries, from high-tech manufacturing to renewable energy and medical technologies. The credit incentivizes business investment in critical areas such as advanced manufacturing and cutting-edge R&D, which are vital for

California's economic future. By allowing companies to invest more in equipment, technology, and materials, this bill helps drive innovation and ensures that businesses continue to thrive in California.

3) The FTB notes the following implementation consideration in its staff analysis of this bill:

   This credit would be contingent upon an appropriation for the administration of the credit in the annual Budget Act or another statute, which could create uncertainty for taxpayers, tax preparers, software providers, and the FTB. In addition, uncertainty may reduce the incentive for taxpayers to invest in qualified TPP. If this is not the intent, the author may want to amend the bill.

4) The FTB also notes the following technical considerations in its staff analysis of this bill:

   a) The first sentence of Sections 17053.90(h)(1) and 23623(h)(1) and Sections 17053.90(h)(2) and 23623(h)(2) provide language, relating to guidance and regulations, that are unnecessary. The author may wish to amend this bill to remove this language.

   b) Sections 17053.90(i)(2) and 23623(i)(2) should be standalone subdivisions of the bill since the paragraphs are not specific to subdivision (i).

5) Committee Staff Comments:

   a) *What is a "tax expenditure"*? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

      As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are reviewed less frequently than direct expenditures once they are put in place. While this affords taxpayers greater financial predictability, it can also result in tax expenditures remaining a part of the tax code without demonstrating any public benefit. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

   b) *California's existing economic development tools*: In 2013, Governor Brown signed legislation that reformed California's economic development policies. [AB 93 (Committee on Budget), Chapter 69, Statutes of 2013.] The new law eliminated enterprise zones and other geographically targeted economic development areas and, instead, created three new economic development tax incentives: (i) a temporary tax credit for wages paid by a taxpayer engaged in a trade or business within a designated census tract, as defined, or a former enterprise zone to certain full-time employees (the "New Employment Credit"); (ii) the California Competes Tax Credit program - a negotiated incentive administered by the Governor's Office of Business and Economic Development; and, (iii) a temporary MR&D SUT exemption.

c) *The existing MR&D exemption*: Until July 1, 2030, existing law provides a partial SUT exemption for a qualified person's purchase of qualified TPP to be primarily used in manufacturing; research and development; or electric power generation, distribution, or storage. The MR&D exemption only applies to the GF components of the statewide SUT rate (3.9375%) and is generally limited to $200 million of TPP purchases by a qualified person in each calendar year.

d) *What would this bill do*? This bill would allow an income tax credit under both the PIT Law and the CT Law equal to the amount of sales tax reimbursement or use tax paid on qualifying purchases that were only partially exempt under the existing SUT exemption for MR&D. Thus, taxpayers with sufficient *income tax* liability would effectively receive the benefit of a full SUT exemption for their MR&D purchases. This bill would accomplish this goal, however, without reducing local revenues via a complete SUT exemption. Instead, the full cost of the incentive program would be borne by the state through reduced GF revenues.

e) *Should manufacturing purchases be fully exempt*? Most experts who have studied state SUT regimes would argue that, in an ideal world, it makes little sense to subject most business-to-business purchases to sales tax. This contention is predicated on the fact that taxing such business inputs often leads to tax pyramiding. Tax pyramiding, in turn, occurs when the same good is taxed multiple times during the production process. Imagine, for example, a manufacturing firm that purchases taxed materials to fabricate an item that is again subject to SUT upon its final sale to a consumer. California's existing MR&D exemption at least partially addresses this problem for qualifying purchases.

   It should be noted, however, that most tax experts would also argue that the current SUT *base* is far too narrow. By only imposing SUT on sales of TPP, California's current consumption tax fails to capture a wide range of consumer services and digital purchases.

f) *Committee's tax expenditure policy*: SB 1335 (Leno), Chapter 845, Statutes of 2014, added R&TC Section 41, which recognized that the Legislature should apply the same level of review used for government spending programs to tax credits introduced on or after January 1, 2015. AB 263 (Burke), Chapter 743, Statutes of 2019, extended the requirements in R&TC Section 41 to all tax expenditure measures under the PIT Law, the CT Law, and the SUT Law introduced on or after January 1, 2020. This Committee has also adopted a policy, requiring that all tax expenditure proposals must comply with the requirements of R&TC Section 41. A tax expenditure proposal must outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements. This bill complies with R&TC Section 41.

   In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to the policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means 10 years. This bill complies with this Committee's policy on sunset dates.

g) *Prior legislation*:

i) AB 52 (Grayson), of the 2023-24 Legislative Session, contained provisions substantially similar to this bill. Governor Newsom vetoed AB 52 and noted the following in his veto message:

> As a strong supporter of California's innovation economy and manufacturing sector, I agree with the intent of this bill. California offers many powerful incentives to encourage new and continued investment in the areas of manufacturing, research, and development. However, by enacting a new tax credit, this bill would have a significant impact on the state general fund, and should be considered in the annual budget process.
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> In partnership with the Legislature this year, my Administration has enacted a balanced budget that avoids deep program cuts to vital services and protected investments in education, health care, climate, public safety, housing, and social service programs that millions of Californians rely on. It is important to remain disciplined when considering bills with significant fiscal implications that are not included in the budget, such as this measure.
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> For these reasons, I cannot sign this bill.

ii) AB 1951 (Grayson), of the 2021-22 Legislative Session, would have expanded, for a five-year period, the existing partial SUT exemption for MR&D by making it a full exemption. Governor Newson vetoed AB 1951 and noted the following in his veto message:

> This bill replaces the current partial manufacturing sales tax exemption with a full exemption until January 1, 2028. This change would result in substantial revenue loss to local governments, which impacts essential health, safety, welfare, and transportation services. Assuming there are no changes in taxpayer behavior, local agencies are estimated to lose over half a billion dollars each year.
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> As a strong supporter of California's business climate and manufacturing industry, I agree with the intent of this bill to invest in California's economy, incentivize innovation, and spur a manufacturing marketplace that is competitive nation-wide. However, we cannot ask our local governments to bear this loss in revenue.
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> With our state facing lower-than-expected revenues over the first few months of this fiscal year, it is important to remain disciplined. The Legislature sent measures with potential costs of well over $20 billion in one-time spending commitments and more than $10 billion in ongoing commitments not accounted for in the state budget. Bills with significant cost pressures, such as this measure, should be considered as part of the annual budget process. For these reasons, I cannot sign this bill.

I look forward to working with the Legislature and stakeholders to propose something on this topic next year.

REGISTERED SUPPORT / OPPOSITION:

Support

California Chamber of Commerce
California Forever
California Manufacturers and Technology Association
California Taxpayers Association
Industrial Environmental Association
Los Angeles Area Chamber of Commerce
Silicon Valley Leadership Group
Western Wood Preserves Institute

Opposition

None on file

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