What is the MIC?

The Manufacturers' Investment Credit, or MIC, is a credit available to a qualified taxpayer that may be used to reduce the taxpayer's income or franchise tax. The credit is 6% of qualified costs paid or incurred on or after January 1, 1994, for acquiring, constructing, or reconstructing qualified property. It is available to qualified taxpayers engaged in manufacturing-type activities. The credit is claimed on the return filed for the taxable or income year in which the qualified property is placed in service in California.

Who is a qualified taxpayer for the MIC?

A qualified taxpayer may be an individual, partnership, corporation, S corporation, or limited liability company (LLC).

A qualified taxpayer must be engaged in at least one line of business that is classified as an operating establishment under Division D, Manufacturing, of the Standard Industrial Classification (SIC) Manual, 1987 edition. Division D includes SIC code numbers 2011 through 3999, inclusive. The specific four-digit industry codes within Division D are listed in the instructions for the Manufacturers' Investment Credit form (FTB 3535).

For income years beginning on or after January 1, 1998, a qualified taxpayer also includes any taxpayer engaged in activities related to computer programming or computer software design described under SIC codes 7371 to 7373.

How do I determine which SIC code(s) to use for MIC purposes?

You can determine your SIC code(s) for MIC purposes by using the classification of business activity rules contained in the introductory section and appendices of the SIC Manual. Your SIC code assigned by other government agencies is not controlling for MIC purposes. Likewise, the Principal Business Activity code that is used for federal and state income tax return purposes may not necessarily reflect your SIC code(s) assignment for MIC purposes, even though they are similar in format and structure to the SIC codes.

May I use the North American Industry Classification System (NAICS) codes instead of using the SIC codes for purposes of claiming the MIC?

No. The business activity classification rules and numbering system used in the SIC Manual are different than those used in the NAICS Manual. Because Revenue and Taxation Code sections 17053.49 and 23469 both reference the SIC Manual, 1987 edition, for purposes of classifying business activities, the NAICS Manual cannot be used as a substitute.

How can I get a SIC Manual?

Contact: **National Technical Information Service**
5285 Port Royal Road
Springfield Virginia 22161

Order No. PB 87-100012

The manual is also available on the Internet at **www.osha.gov/oshstats/sicser.html**.

What is qualified property for the MIC?

Generally, qualified property is new or used tangible personal property defined in Internal Revenue Code section 1245(a). It must be used primarily (50% or more of the time) in a manufacturing or other qualified activity. Qualified activities include:

- Manufacturing, processing, refining, fabricating, or recycling; or
- Research and development; or
- Maintaining, repairing, testing, or measuring other qualified property; or
- Pollution control (meeting or exceeding established state or local standards).

Qualified property also includes certain special purpose buildings and foundations used by certain qualified taxpayers engaged in certain manufacturing activities. Generally, these include biotechnology, biopharmaceutical, aerospace, computer, and computer chips.

For tax years beginning on or after January 1, 1998, qualified property also includes computer and computer peripheral equipment (as defined in IRC section 168(i)(2)(B)) that is used in operating establishments classified under SIC Codes 7371 to 7373 to primarily develop or manufacture prepackaged software.

What are qualified costs for the MIC?

To qualify for the credit, costs must meet all of the following criteria:

- Paid or incurred on or after January 1, 1994, for the acquisition, construction, or reconstruction of qualified property;
- Amounts upon which California sales or use tax was paid (except for capitalized labor costs); and
- Amounts that are chargeable to the qualified taxpayer's capital account (basis for depreciation), except for certain operating or true leases.

Qualified costs may also include **capitalized labor costs** that are direct costs of labor and are allocable to the construction or modification of qualified property. Direct costs of labor include wages, overtime pay, vacation, payroll taxes, and sick pay (IRC Section 263A), but do NOT include training costs, officer's compensation, pension and other related costs, and employee benefit expenses.

How is the MIC claimed?

The MIC is claimed on a Manufacturers' Investment Credit form (FTB 3535), for the year in which the qualified property is placed in service in California. Note that 1995 was the first year the MIC could be claimed. Thus, any credit earned during the 1994 taxable or income year MUST be claimed on the 1995 form FTB 3535.

Can a qualified taxpayer amend a prior year return to claim the MIC?

Yes, as long as the applicable statute of limitations is open (generally four years from the original due date of the return, or one year from the date of the overpayment, whichever period expires later).

What are the limitations on the MIC?

There is no annual dollar limitation on the amount of MIC a qualified taxpayer may claim during any year. Any MIC exceeding the tax liability for the current year may be carried over to future years (but see next question).

The credit cannot be claimed for any property for which a California sales or use tax exemption or refund has been claimed. The credit cannot reduce the minimum franchise tax (corporations, LLCs, limited partnerships, limited liability partnerships, and S corporations), built-in-gains tax (S corporations) or the excess net passive income tax (S corporations). Also, the credit cannot reduce the total income fee paid by LLCs taxed as partnerships.

May the MIC be carried over to future years?

Yes. Generally, any part of the credit exceeding the tax liability for the current taxable or income year may be carried over for a maximum of eight years. Some small businesses qualify for a ten-year carryover period.

Is the MIC a refundable credit?

No. Any MIC that is not used to offset the qualified taxpayer's income or franchise tax must be carried over to future years.

May the credit reduce the alternative minimum tax (AMT)?

No. The credit may not reduce the AMT; however, the credit may reduce the regular tax below the tentative minimum tax.

Does the taxpayer have to be a new business to qualify for the MIC?

No. New and old businesses alike may claim the MIC. There is no requirement that a business be new to qualify for the MIC. However, California's partial sales or use tax exemption for manufacturers does require a business to be a new business.

What is the partial sales or use tax exemption for manufacturers?

The partial sales or use tax exemption is available for new or start-up businesses in California. The exemption is limited to 5% of qualified costs. The manufacturers' partial exemption generally applies to the same property as the MIC. However, you must elect to claim either the partial exemption or the MIC; you cannot claim both for the same item of qualified property. For more information on the partial sales or use tax exemption, contact the California State Board of Equalization at (800) 400-7115.

May a taxpayer claim other tax incentives, such as enterprise zone credits, enterprise zone business expense deductions, or Los Angeles Revitalization Zone (LARZ) credits, or deductions for the same property?

Taxpayers operating in an Enterprise Zone — Taxpayers may claim the enterprise zone sales or use tax credit and the MIC for the same property. However, for purposes of claiming the MIC, the amount of sales or use tax paid is not included in the cost of the item of qualified property. Taxpayers may also claim the enterprise zone business expense deduction on the same property, but must reduce MIC qualified costs by the amount of that deduction before computing the MIC.

Taxpayers operating in the LARZ — Taxpayers may NOT claim both the LARZ **sales or use tax credit** and the MIC for the same property. If you elect to claim the LARZ **business expense deduction,** you cannot claim the MIC for the same property.

RELATED FTB FORMS AND PUBLICATIONS

FTB 3535	**Manufacturers' Investment Credit**
FTB Pub. 1044	**Guidelines For Los Angeles Revitalization Zone Tax Incentives**
FTB Pub. 1047	**Guidelines For Enterprise Zone Tax Incentives**

You may order these FTB publications by calling:

From within the United States.....
1-800-852-5711

From outside the United States (not toll free).....
1-916-845-6500

or writing to:

TAX FORMS REQUEST UNIT
PO BOX 307
RANCHO CORDOVA CA 95741-0307

Assistance for persons with disabilities:

We comply with provisions of the Americans with Disabilities Act. For persons with hearing or speech impairments:

from **voice phone call (800) 735-2922** or

from **TTY/TDD call (800) 822-6268**.

INTERNET ACCESS

Most California income tax forms and publications are available through the Franchise Tax Board's website, where you can download, view, and print California income tax forms and publications. Our Internet address is:

www.ftb.ca.gov.

Do operating leases qualify for the MIC?

Yes. If the sales or use tax is paid by the lessor when the property is acquired, the lessee may claim the credit for qualified costs for the year in which the lessee placed the qualified property in service in California, assuming all other requirements are met. The lessor MUST acquire the qualified property on or after January 1, 1994, and the lease with the qualified taxpayer (lessee) must also have commenced on or after January 1, 1994.

- Under an operating or true lease, the property does <u>not</u> have to be chargeable to the qualified taxpayer's (lessee's) capital account.

- Within 45 days after the close of the lessee's taxable or income year for which the MIC is allowable, the lessor MUST provide a statement to the lessee specifying the amount of the lessor's cost upon which sales or use tax has been paid and the amount of qualified costs eligible for the credit.

What are considered qualified costs for purposes of the credit under an operating lease?

The lessee uses the lessor's original cost of the qualified property to compute the credit. (See "What are qualified costs?" above). Generally, the lessor's original cost basis is equal to the lessor's cost for depreciation purposes, less any California sales or use tax paid that is included in the cost basis. Only the amounts on which California sales or use tax have been paid plus any qualified capitalized direct labor costs are eligible for the credit. California sales or use tax may have been paid directly or indirectly by the lessor to qualify for the credit.

NOTE: *If the lessor does not pay the sales or use tax at the time the property is acquired, the lessee may not claim the credit.*

Does research and development (R&D) property qualify for the MIC?

Yes. R&D property can qualify for the MIC provided the property is used in an R&D activity that supports the manufacturing process. Costs expensed under IRC Section 174 are not qualified costs for the MIC. R&D companies, that are not classified under Division D, Manufacturing, SIC codes, are generally not qualified taxpayers for the MIC.

May the MIC be passed through to partners of partnerships, shareholders of S Corporations, or members of LLCs that are taxed as partnerships?

Yes. The MIC is passed through to these taxpayers in the same manner as other credits. In the case of S corporations, the corporation may claim one third of the credit against the 1.5 percent entity-level tax and then pass through 100% of the credit to the S corporation shareholders. In the case of partnerships and LLCs taxed as partnerships, the credit is earned at the entity level and passed through to partners or members.

Is there basis reduction with the MIC?

No. Unlike some credits, there is no basis reduction for depreciation purposes when a taxpayer claims the MIC.

May the MIC be transferred or allocated to an affiliated taxpayer, corporation, or a member of a unitary group?

No. The MIC (including any carryover) is allowed only to the qualified taxpayer that paid or incurred the qualified costs and thus earned the credit. For example, a subsidiary corporation that places qualified property in service and generates a MIC may not allocate the credit to the parent corporation. A corporation that is a member of a unitary group may not allocate or otherwise transfer the credit to any other member of the unitary group.

Under what circumstances must the MIC be recaptured?

If within one year from the date property is first placed in service in California, the property is removed from California, disposed of to an unrelated party, or used primarily (50% or more of the time) in a nonqualified activity, you must recapture any claimed MIC.

NOTE: *If a disqualifying event occurs in the same income year ending in which the property is placed in service, it's NOT recaptured, it's never allowed.*

Does FTB have regulations providing additional guidance for the MIC?

Yes. The MIC regulations are in the California Code of Regulations, Title 18, sections 17053.49-0 through 17053.49-11 (Personal Income Tax) and 23649-0 through 23649-11 (Bank and Corporation Tax).