Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Rod Pacheco	Analyst:	Roger Lackey	Bill Number:	AB 15X
Related Bills:	See Legislative History	Telephone:	845-3627	Introduced Date:	01-24-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Energy Conservation Credit

SUMMARY

This bill would allow a 100% credit for the purchase of energy conservation measures that reduce electricity and natural gas used by a taxpayer by 5% from the previous taxable year.

PURPOSE OF THE BILL

Based on dicussions with the author's staff, the purpose of this bill is to promote energy conservation and improve energy efficiency.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to work with the author's office to resolve the implementation, technical, and policy considerations discussed below.

ANALYSIS

FEDERAL/STATE LAW

Federal law currently provides two energy-related credits: an energy investment credit, and a business credit for the production of electricity from certain renewable resources.

The energy investment credit is equal to 10% of the basis of energy property placed in service during the taxable year. Energy property includes equipment that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. It also includes equipment that produces, distributes, or uses energy derived from geothermal deposits. The equipment also must meet performance and quality standards prescribed by federal regulations.

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The business credit for the production of electricity from certain renewable resources is equal to 1.5 cents multiplied by the kilowatt hours produced by the taxpayer's qualified energy resource and facility. To qualify, the energy must be sold to an unrelated person during the taxable year. Qualified renewable energy resources include wind, closed-loop biomass, and poultry waste.

Prior federal law allowed a credit equal to 15%, up to a maximum total credit of $300, for the purchase and installation of energy-saving components in an individual's residence. The qualifying expenditures included such items as:

- energy efficient furnace burners and electrical or mechanical furnace ignition systems; and
- storm or thermal windows or doors, and caulking or weather-stripping of exterior doors or windows.

A separate federal credit equal to 40% of the costs, up to a maximum total credit of $4,000, was allowed for tax years 1979-1986. That credit was based on the purchase and installation of renewable energy equipment, such as solar energy systems, and wind and geothermal energy equipment. The renewable energy equipment was required to be installed in an individual's primary residence located in the United States. The equipment must have been new when installed and have had an expected useful life of at least five years.

Prior state law allowed a credit equal to a percentage of the cost of energy conservation measures. The credit was changed a number of times during its lifetime and was available for tax years 1977-1986. In later years, the credit for residential property was 40% of allowable costs for tax years 1981-1983 and 35% for tax years 1984-86. Energy measures that qualified for the credit were similar to those in the federal credit.

If the federal credit was allowed on the same costs, the state credit was reduced by the amount of the federal credit. For residential properties, the combined federal and state credits could not exceed 40% of cost. For nonresidential properties, the combined federal and state credits could not exceed 40% of cost except where the cost exceeded $6,000. In this case, the federal credit was limited to 25% of costs, and the state credit was reduced by the amount of the federal credit. The state credit was limited to a maximum of $1,500. In addition, the state credit could not be claimed if the amount of state credit for any given year would have been less than $10.

The energy conservation credit could not be claimed for costs on which the solar energy credit was also claimed.

Current state law does not provide a credit for energy conservation measures.

THIS BILL

This bill would allow a 100% credit for the amounts paid or incurred for energy conservation measures that reduce a taxpayer's electricity and natural gas use by 5% from the previous taxable year.

"Energy conservation measures" would include, but not be limited to, replacing or installing air conditioners, refrigerators, windows, insulation, weather-stripping, low-flow devices, ventilation cooling fans, attic ventilators, economizer systems, and heaters with more energy efficient models, devices, or designs.

This bill would not allow a deduction for any cost on which a credit is allowed.

This bill would allow any excess credit to be carried over indefinitely.

IMPLEMENTATION CONSIDERATIONS

It is unclear how the 5% reduction in electricity and natural gas usage will be verified.

Although this bill requires a reduction in the amount of electricity and natural gas used in California to qualify for the credit, there is no express requirement that the "energy conservation measures" be replaced or installed on property in California.

The 5% reduction in the usage of electricity and natural gas must occur during the taxable year in which the cost of the energy conservation measure was paid or incurred. However, there is no requirement for a causal relationship between the "energy conservation measures" and the reduction in electricity and natural gas usage.

The phrase "energy conservation measures" is not clearly defined. Consequently, if there has been a 5% reduction in electricity and natural gas used by a taxpayer in a given taxable year, 100% of the costs of every "energy conservation measure" paid or incurred during that taxable year is eligible for this credit. The absence of clarity regarding the meaning of the phrase "energy conservation measure" will lead to disputes with taxpayers and increase the costs to the department to administer this credit. As an example, prior law provided a credit for "solar energy systems." That term was not well defined. An appellate court was required to determine whether costs of installing counter and floor tile and windows facing south were eligible for the solar energy credit. In William Lyon Co. vs. Franchise Tax Board (4 Cal App. 4th, 267, 1992), the court denied the credit because the tile and windows were not a part of a "system" and the windows increased summer cooling costs. The phrase "energy conservation measure" should be defined to eliminate similiar disputes that would occur.

Although taxable years are normally 12 months, a taxable year may be less than 12 months. Consequently, this bill may provide a credit if one taxable year is 5% shorter in duration than the preceding taxable year, but without any overall reduction in electricity or natural gas usage over comparable periods of time.

The terms "insulation," "low-flow devices," and "economizer systems" are undefined.

It is unclear if "energy conservation measures" would apply to used or refurbished items or whether it was the author's intent to have it only apply to new items. If the author intends the latter, it may be appropriate to amend the bill accordingly.

It is unclear if this bill would apply to items being added to the home. For example, a taxpayer adding a room to his or her home may include new windows, insulation, etc. that fall within the meaning of "energy conservation measure." As written, this bill could subsidize a taxpayer's home remodel even when a 5% reduction in electricity and natural gas used is realized unrelated to the addition.

Public utilities often offer grant programs to encourage people to install and use energy conservation measures. Generally, the amount of any grant received that assisted a taxpayer in the purchase and installation of an eligible item reduces a credit allowed for the same expense. This bill requires no such reduction of the credit.

This bill provides no limitation on the number of “energy conservation measures” a taxpayer can replace or install.

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a limitation on the number of years for carryovers since experience shows credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATIONS

The bill specifies that no deduction "may" be allowed for any cost for which this section allows a credit. To reinforce the "no deduction" prohibition, it might be preferable to replace "may" (which is permissive language) with "shall" (which is mandate language) to clarify the author's apparent intention.

LEGISLATIVE HISTORY

AB 873 (1997/1998) would have allowed a credit equal to 40% of the cost of energy conservation measures. The bill also would have allowed a second credit equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes, subject to certain requirements. The bill failed to pass the Assembly Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or $1,000, whichever is less.

New York: For personal income tax (PIT) only, New York allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at $3,700 per system.

Michigan: Does not allow an energy-related credit, but exempts the value of energy conservation devices from the local property tax.

Oregon: Currently has two energy credits, a PIT consumer energy purchases credit and a corporate tax credit for the costs of energy projects. The consumer energy purchases credit allows various credits ranging from $50 to $1,500 for consumer purchases of certain items. The corporate credit for the costs of energy projects is a credit equal to 35% of the incremental costs of the project involving energy conservation and other related projects.

FISCAL IMPACT

Implementing this bill would not significantly impact the department’s programs and operations.

ECONOMIC IMPACT

Tax Revenue Estimate

Due to the lack of specifications in the bill and the likely disputes with taxpayers concerning the amount and availability of this credit, the magnitude of revenue losses are speculative at this time but could easily be on the order of $1 billion annually beginning in 2001-02.

Tax Revenue Discussion

Energy conservation measures and costs that may be claimed as credits are unlimited under the bill as currently drafted. Examples of such measures can range in cost from a few dollars for weather stripping to several thousand dollars for a new furnace, air conditioner, carpeting, drapes, etc. in a home to hundreds of thousands of dollars or more in a commercial facility.

Potential abuse of the credit could be significant. Some taxpayers could voluntarily reduce energy consumption during the year by at least 5% and receive a credit for any number of expenses considered "energy conservation measures" during the year. Other taxpayers would claim credits for part-year energy usage in a new home compared to full-year usage in a previous home.

There are roughly 11.6 million residential units and nearly 425,000 non-governmental and non-tax-exempt commercial buildings in California. If one in 10 taxpayers that own these roughly 12 million structures incur qualifying costs of $1,000 on average, credits generated would total $1.2 billion.

ARGUMENTS/POLICY CONCERNS

This bill would allow a tax credit equal to 100% of the costs. A 100% tax credit is unprecedented.

Geographical locations and seasonal weather patterns may play a significant role in whether a taxpayer meets the 5% reduction in usage. Unseasonable weather may eliminate certain taxpayers from being eligible, even if their expenditures are within the meaning of "energy conservation measure."

This bill does not contain a sunset date. Generally, credits contain a sunset date that allows the Legislature to review the credit for its effectiveness.

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