

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Nakano Analyst: LuAnna Hass Bill Number: AB 845

Related Bills: See Legislative History Telephone: 845-4073 Amended Date: April 16, 2001

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Alternative Technology Credit

## SUMMARY

This bill would allow a credit of 50% for the cost of using alternative dry or wet cleaning technology that is better for air and water quality.

## SUMMARY OF AMENDMENTS

The April 16, 2001, amendments modified the definition of "qualified alternative technology," and added a requirement that the State Air Resources Board (SARB) grant a preference to technologies that provide energy efficiency.

This is the department's first analysis of the bill.

## PURPOSE OF THE BILL

The purpose of this bill is to make alternative dry cleaning technology economically feasible.

## EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2002, and would apply to taxable years beginning on or after that date.

## POSITION

Pending.

### Summary of Suggested Amendments

Amendments are needed to clarify definitions for improved air quality, water quality, and qualified alternative technology. Amendments also are needed to establish a certification process for the proposed credit. See "Implementation Considerations" below. Department staff is available to assist the author with these or any other amendments.

Board Position:

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\_\_\_\_ N      \_\_\_\_ OUA      \_\_\_\_ X PENDING

Department Director

Date

Alan Hunter for GHG

05/21/2001

## **ANALYSIS**

### FEDERAL/STATE LAWS

Both state and federal laws allow a deduction for all ordinary and necessary expenses of a trade or business. If the expense is for a repair to existing equipment that does not extend the useful life of such equipment, it is deductible in the year paid or incurred. If the expense is for a replacement and the useful life of the equipment replaced is more than one year, or the expense is for a repair that extends the useful life of the equipment, the cost of the item is recoverable through depreciation over the useful life of the equipment.

Both state and federal laws provide various tax credits designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Neither state nor federal laws currently allow a credit comparable to the credit proposed by this bill.

### THIS BILL

This bill would allow a tax credit equal to 50% of the cost paid for implementing qualified alternative dry or wet cleaning technology as determined by SARB.

Under the Health and Safety Code, this bill would require SARB to designate qualified alternative technologies that are more protective of air quality and water quality than dry cleaning technologies that use perchloroethylene, known as PERC or tetrachloroethylene (PCE). SARB would be required to grant a preference to those dry or wet cleaning technologies that provide energy efficiency.

The bill defines "qualified alternative technology" in the Health and Safety Code as dry or wet cleaning technology that is designated by SARB. The bill would specifically exclude any technology that uses any substance known to the state to cause cancer or reproductive toxicity, or that incorporates any other substance that the state board determines that the state does not possess adequate or complete health effect or environmental fate studies.

### IMPLEMENTATION CONSIDERATIONS

The credit would be based on the "cost paid for implementing qualified alternative technology." However, the language does not define those items that would be included in cost. For example, the bill does not specify whether costs would include the purchase or lease and installation of such technology. In addition, the bill requires the cost to be "paid." Consequently, the credit would not be available to taxpayers using the accrual method of accounting in the year that the cost was "incurred."

The credit would apply to technology "as determined by SARB." However, the bill does not specify whether SARB would establish eligible costs, guidelines, and criteria for the dry cleaning technology. Typically, credits in areas where the department does not possess expertise are certified by another agency or agencies that possesses the relevant expertise. The certification language would specify the responsibilities of both the certifying agencies and the taxpayer. In this instance, the certification process would require multi-media assessments for air, water, ground water, and soil control.

An inter-agency task force would need to be created to address the certification issues and could consist of SARB, State Water Resources Control Board (SWRCB), Office of Environmental Health Hazard Assessment, and the United States Environmental Protection Agency's multi-media assessment groups.

The bill would require SARB to designate qualified alternative technologies that are "more protective" of air and water quality. However, the bill does not specify the level of improvement that would be needed to qualify for the credit. Although SARB regulates air quality, it does not regulate water quality standards. Therefore, the bill also would need to identify an agency, possibly SWRCB as part of the inter-agency task force, that would be responsible for determining the impact of the qualified alternative technologies on water quality.

SARB would be required to grant a preference to those technologies that provide "energy efficiency." However, the bill does not define energy efficiency for purposes of this credit. This issue could be addressed by the California Energy Commission as part of the inter-agency task force mentioned above.

The bill requires the technology to be "implemented." However, it does not specify that the technology must be actually used after being "implemented" or for how long it must be used for the taxpayer to receive the credit. Further, it is not clear if the credit is allowed in the taxable year in which the cost was paid or the taxable year in which the qualified alternative technology is "implemented."

The bill contains a broad statement that the technology qualifying for the credit may not include any substance known to cause cancer or reproductive toxicity or any other substance that the state board (SARB) does not possess adequate or complete health effect or environmental fate studies. However, the bill lacks a specific requirement that the taxpayer must cease use of dry cleaning technologies that use PERC or PCE.

The bill does not specify whether the technology must be purchased "new" or whether existing technology that is updated would also qualify for the credit. Lacking a specific provision on this point, new or used technology would potentially qualify for the credit if it meets SARB requirements.

The credit would be operative for taxable years beginning on or after January 1, 2002. However, the bill does not specify a date by which SARB must have designated the dry or wet cleaning technology that would qualify for this credit. Thus, taxpayers would not be able to determine if the cost of such technology qualifies for the credit until SARB makes its determination.

## **PROGRAM BACKGROUND**

PERC or PCE is a colorless, nonflammable liquid that can adversely affect the human nervous system. The largest United States user of PERC is the dry cleaning industry. PERC is also found in typewriter correction fluid and shoe polish. An estimated 35,000 dry cleaners in the U.S. and Canada use 300 million pounds of PERC each year.

The Environmental Protection Agency (EPA) lists PERC as both a possible carcinogen and a hazardous ground and air pollutant. The EPA has adopted national emissions standards for PERC and required states to adopt these standards or develop their own. Since 1993, SARB has regulated PERC emissions and has classified PERC as a toxic air contaminant.

SARB estimates that PERC emissions have since been reduced by 95 percent. However, SARB does not regulate water quality standards. The Occupational Health and Safety Administration (OSHA) has established workplace limits on exposure to PERC. The disposal of PERC also is regulated as a hazardous waste.

New alternative dry cleaning technologies are being developed and patented. Greenpeace in conjunction with the Center for Neighborhood Technology and the EPA has promoted "Eco-Clean," an "organic" washing process or "multiprocess wet technology." However, the International Fabricare Institute and Neighborhood Cleaners Association maintain that water-based cleaning processes cannot clean all types of garments, and the elimination of PERC would be the end of "dry clean only" garments.

### **OTHER STATES' INFORMATION**

*Massachusetts, Michigan, and Oregon* laws do not provide a credit comparable to the credit proposed by this bill.

*New York:* Introduced legislation in 2001 that would allow a credit for costs related to the abatement of pollution or contaminants from the operation of a dry cleaning plant.

*Florida:* Provides a 35% credit of costs for the voluntary cleanup of qualified dry cleaning-solvent-contaminated areas or designated Brownfield sites. The credit is allowed against Florida intangible property taxes or Florida corporate income taxes. (Florida does not have a personal income tax.) The credit is limited to \$2 million annually for a cleanup. An additional 10% of clean-up costs, up to \$50,000, may be claimed in the final year of cleanup. In addition, pollution control and clean-up equipment are exempt from sales or use tax, provided the equipment is certified to meet the Department of Environmental Protections requirements.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

### **FISCAL IMPACT**

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

### **ECONOMIC IMPACT**

Revenue Estimate: Unknown at this time, but potentially very significant, in the tens of millions of dollars.

Revenue Discussion: The impact of this bill would depend upon the type of qualified alternative technologies eventually designated as more protective by the SARB, the time that such designation is made, the number of establishments impacted, the cost of implementing the qualified alternative technologies that could vary considerably, associated costs deemed allowable such as franchise fees, etc., and the average credit applied against tax liabilities.

## **ARGUMENTS/POLICY CONCERNS**

The bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review the effectiveness of the credit.

By allowing the taxpayer to claim the proposed credit in addition to any deduction allowed for the same expenses, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense. Conflicting tax policies come into play in this situation. This new credit would have the effect of providing a double benefit. On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a state and federal difference that is contrary to the state's general conformity policy. In the case of a one-time expense deduction, the reduction of that expense would not create an on-going difference.

The bill does not restrict the credit to those costs associated with dry cleaning businesses located within this state. Thus, a taxpayer with California tax liability could potentially claim this credit for costs related to a dry cleaning business operated outside California.

Taxpayers are generally required to recapture the credit amount by adding it back to their tax liability if the associated item is subsequently sold or put to an unqualified use (including non-use) within a specific amount of time after the purchase date. This bill does not provide a recapture provision.

## **LEGISLATIVE STAFF CONTACT**

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