

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: Roger Lackey Bill Number: AB 86X

Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 02-26-2001

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

**SUBJECT:** Solar Energy Credit

## SUMMARY

This bill would allow an individual a credit for 75% of the cost to purchase or lease and to install a solar energy system.

## PURPOSE OF THE BILL

The author's staff has indicated that the intent is to revive the former solar energy credit.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2006.

## POSITION

Pending.

### Summary of Suggested Amendments

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

## ANALYSIS

### FEDERAL/STATE LAW

**Federal law** currently provides two energy-related credits: an energy credit that is one portion of the 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.

Board Position:

\_\_\_\_\_ S      \_\_\_\_\_ NA      \_\_\_\_\_ NP  
\_\_\_\_\_ SA      \_\_\_\_\_ O      \_\_\_\_\_ NAR  
\_\_\_\_\_ N      \_\_\_\_\_ OUA      \_\_\_\_\_ X PENDING

Department Director

Date

Gerald H. Goldberg

05/25/01

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

**Former state law** provided a credit equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes. The credit was available for taxable or income years beginning on or after January 1, 1990, and before January 1, 1994.

The credit provisions defined "solar energy system" as solar, thermal, electric, and photovoltaic systems, but did not include devices that produced electricity through wind energy or energy conservation measures.

The former solar energy credit is further discussed under "PROGRAM BACKGROUND" below.

**Current state law** does not provide a credit for the purchase and installation of solar energy systems.

### THIS BILL

Under the Personal Income Tax Law (PITL), this bill would allow a credit equal to 75% of the cost to purchase or lease and to install a solar energy system on property located in California that is used for residential purposes. The credit would be calculated after deducting the value of any grants received by the taxpayer from a public entity that offset the cost of the solar energy system.

Taxpayer's that lease and install a solar energy system would only be allowed to claim the principle portions of the lease payments, excluding interest and other charges. The lease term for the solar energy system could not exceed 10 years.

A "solar energy system" would be defined as the use of solar devices designed or intended for the individual function of production of electricity in excess of 30 watts per device. A solar energy system would include solar thermal electric systems and photovoltaic systems. A solar energy system would not include solar devices that use wind energy for the production of electricity or mechanical work.

A "solar device" would mean the equipment associated with the collection, conversion, transfer, distribution, storage, or control of solar energy. In the case of a solar device associated with two or more solar energy systems, the credit allowed for the solar device may be taken for any one of the systems, or divided equally between them.

This bill would define several other terms including; "cost," "installed," "municipal solar utility," "owner," "premises," "residential purposes," and "single-family dwelling."

Any excess credit could be carried over until exhausted.

The bill provides rules regarding the division of the credit in the case of:

- A husband and wife who file a separate return.
- A multiple owner of premises on which a solar energy system is installed.
- Partnerships.

This bill would not allow a credit for any expenditure that was otherwise claimed as a tax credit for the current or any prior taxable year as an energy conservation measure.

This bill would provide Franchise Tax Board (FTB) the authority to prescribe regulations as may be necessary to carry out the purposes of the credit.

This bill would require the Energy Resources Conservation and Development Commission (Commission) to establish limits on the eligible costs for a solar energy system in terms of dollars per kilowatts. The Commission also would be required to develop guidelines and criteria for the solar energy systems including, minimum requirements for safety, market readiness, reliability, and durability.

Any solar energy system certified by the Commission would be eligible for the credit.

Qualification for a credit for a solar energy system with generating capacity in excess of 100 kilowatts is limited to those systems for which the taxpayer has obtained a finding of eligibility from the Commission.

This bill would give the Commission the authority to request the social security number or taxpayer identification number of claimants for the purposes of reporting to FTB the taxpayers that claimed the credit.

#### IMPLEMENTATION CONSIDERATIONS

The bill lacks both a requirement that a solar energy system be used after installation and a minimum requirement of the amount of kilowatt hours to be generated per month, if that is the author's intent.

The terms "thermal electric system" and "photovoltaic" are not defined.

This bill would prohibit a taxpayer from claiming a credit for any expenditures that were currently or previously claimed as an "energy conservation measure under this part." Currently, there is no credit for energy conservation measures. This language should be deleted from the bill.

It is not clear how it would be verified whether a lessor irrevocably elected to not to claim the credit. The bill provides that the lessee can confirm in writing if necessary. The lack of requiring all elections to be in writing may prove difficult in verifying certain lessee/lessor eligibility in claiming the credit.

The bill provides rules for dividing the credit if there is more than one owner of the premises on which the system is installed. Under normal rules, if two or more taxpayers *share the costs* eligible for a tax credit, each taxpayer is eligible to receive the tax credit in proportion to his or her respective share of the costs paid or incurred. This bill allocates the credit on the basis of ownership in the premises, regardless of the respective share of the eligible costs paid by each owner. This may be confusing for taxpayers.

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

The bill specifies that eligible solar energy systems must have a useful life of not less than 5 years but does not limit this requirement to useful life for depreciation purposes and does not specify the consequences for failing to meet the five year useful life requirement. Generally with other income tax credits when a taxpayer fails to comply with the requirements of the credit, the taxpayer is required to recapture any amount of the credit that has been claimed.

Finally, the former solar energy credit that this bill is based on contained a section of uncodified law. The uncodified law required that a solar energy system be composed of interrelated elements that were designed and intended at the time of installation to perform the individual functions prescribed by the credit. The law also stated that no credit would be allowed for any structural components that were not designed and intended at the time of installation to constitute a solar energy system. The author may wish to consider adding the uncodified law to this bill.

### TECHNICAL CONSIDERATIONS

State law contains general provisions regarding how husbands and wives shall divide tax credits. The language in this bill providing for division of the credit between husbands and wives is not necessary and should be removed from the bill. The provisions regarding the division of the credit between partners is addressed under Arguments/Policy Concerns below.

### **LEGISLATIVE HISTORY**

AB 1264 (Campbell, 2001/2002) is the identical regular session version of this bill.

AB 27X and AB 1124 (Koretz, 2001/2002) would allow multiple credits and an accelerated depreciation deduction for the purchase of a power generation system. Both bills are in Assembly Revenue and Taxation Committee. AB 15X (Rod Pacheco, 2001/2002) would allow a 100% credit for the purchase of energy conservation measures that reduce a taxpayer's electricity and natural gas use by 5% from the previous taxable year. This bill is in Assembly Revenue and Taxation Committee. AB 79X (Nakano, 2001/2001) would allow a 40% credit for the purchase or lease of a solar energy credit. This bill is in Assembly Revenue and Taxation Committee. SB 17X (Brulte, 2001/2002) would allow a credit for the purchase and installation of a solar energy system for the production of electricity. This bill is in Senate Revenue and Taxation Committee.

AB 873 (Takasugi, 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.

### **PROGRAM BACKGROUND**

For taxable years 1990 through 1993, state law allowed a tax credit of 10% of the cost of a solar energy system installed on premises, used for commercial purposes that were located in California, and owned or leased by the taxpayer. The credit could not be claimed for any solar energy system with a generating capacity in excess of 30 megawatts for any taxable year unless the federal government provided at least a 10% federal credit for that solar energy system.

For 1987 and 1988 state law allowed a credit of 12% of the cost of commercial solar energy systems installed on commercial premises, cooperatives, apartment buildings, or other similar multiple dwellings.

From 1976 to 1988 state law allowed the solar energy tax credit for personal and commercial premises. The credit was refundable for modest income individual taxpayers until 1982 and was significantly modified several times. The credit was allowed as a percentage of the purchase and installation costs of solar energy systems on premises owned by the taxpayer. Except for taxpayers allowed a refund, any unused credit could be carried over indefinitely.

In 1987, the percentages allowed for the solar energy tax credit were 10% of the eligible costs for single-family dwellings, not to exceed a credit of \$1,000. For commercial property the percentage was 25% of the eligible costs.

### **OTHER STATES' INFORMATION**

The laws of the following states were reviewed because their tax laws are similar to California's income tax laws:

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

*New York:* For personal income tax 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 personal income tax 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**

Once the implementation considerations are resolved, this bill would not significantly impact the department's costs.

### **ECONOMIC IMPACT**

#### Tax Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows:

Revenue Impact of ABX86 For Taxable Years Beginning 1/1/2001 Assumed Enactment After 6/30/01 Fiscal Year Impact (In Millions)		
2001-2	2002-3	2003-4
-\$45	-\$70	-\$85

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

### Tax Revenue Discussion

The impact of this bill would depend upon the number of taxpayers incurring qualifying solar energy expenses and the average credit applied against tax liabilities.

Despite low levels of solar electrical use currently by homeowners, a very significant incentive effect under the proposal is expected. Qualifying solar system costs can vary significantly. For this analysis an average cost of \$13,200 for 2001 was used (net of special rebate programs). Estimates assume that solar energy systems meeting the requirements of this proposal will be installed on 1% of all single-family homes by 2006.

### ARGUMENTS/POLICY CONCERNS

The cost associated with the taxpayer's solar energy system also may qualify for a similar federal credit. Where a taxpayer has claimed a similar federal credit for the purchase and installation of a solar energy system, the author may want to require the cost used to calculate the state credit to be reduced by any federal credit received for those same costs.

Generally, credits require taxpayers to recapture the credit amount by adding the amount of the credit back to their tax liability if the item that qualified for the credit is subsequently sold or removed from the state within a specific amount of time after the purchase date. This bill requires no such recapture of the credit.

Conflicting tax policies come into play whenever a credit is provided for an item which is already deductible as a business expense or is depreciable. Providing both a credit and a deduction for the same expenditure would have the effect of providing a double benefit for that item. On the other hand, an adjustment to reduce basis, as provided by this bill, in order to eliminate the double benefit creates a continuing difference between state and federal taxable income, which is contrary to the state's general conformity policy. In the case of a one-time business expense deduction, the reduction of that expense by the amount of the credit would not create an ongoing difference.

This bill would allow a credit under the PITL, but would not allow the same credit under the Bank and Corporation Tax Law (B&CTL).

In the case of a partnership, the bill allows for the credit to be divided between the partners pursuant to a written partnership agreement. Contrary to existing law, this provision would permit the partnership to divide the credit among partners without regard to "substantial economic effect." Language to the same effect was included in a bill providing the same treatment for partnerships with regard to the low-income housing credit. The Governor identified the provision as a principal reason for vetoing AB 1903 (Lowenthal) last year.

### **LEGISLATIVE STAFF CONTACT**

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