Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Soto	Analyst:	Darrine Distefano	Bill Number:	SB 16XX
Related Bills:	See Legislative History	Telephone:	845-6458	Introduced Date:	05-17-2001
		Attorney:	Patrick Kusiak	Sponsor:	Milk Producers Council

SUBJECT: Dairy Farm Electric Generator Refundable Credit

SUMMARY

This bill would create a refundable tax credit equal to half of the expenses for the purchase and installation of generators used to produce electricity at dairy farms located in California.

PURPOSE OF THE BILL

This bill provides that the intent of the Legislature is to establish a tax credit for dairy farms to purchase and operate on-site power generators for them to produce their own power.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Neutral.

At its May 2, 2001, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on SB 16X, which is identical to this bill. Annette Porini, on behalf of Member B. Timothy Gage, abstained.

Summary of Suggested Amendments

An amendment is provided to address the department's technical concern. Department staff is available to assist with amendments to resolve the implementation and policy concerns described below.

An amendment is suggested to provide appropriation language to fund the departmental costs associated with administering the proposed credit.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Jana Howard for B.P.	06/01/01
__X__ N	____ OUA	____ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Both state and federal laws allow a deduction for all ordinary and necessary expenses of a trade or business, including expenses relating to energy conservation measures. 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 repair extends the useful life of the equipment, the cost can be depreciated 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 have a credit comparable to the credit proposed by this bill.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would create a tax credit equal to 50% of the expenses paid or incurred for the purchase of a new, or the alteration, modification, or remanufacture of an existing, qualified portable or permanent generator that provides electric service onsite at a dairy farm located in California.

The bill specifies the credit would only be allowed for the taxable year in which the generator is first put into operation.

The bill defines "expenses" to include the purchase price of the generator and all expenses for its installation, upgrade, or expansion. "Dairy farm" would be defined, by reference to Section 32505 of the Food and Agricultural Code, to mean any place or premises upon which milk is produced for sale or other distribution and where more than two cows or six goats are in lactation.

The bill defines “qualified generator” as a generator powered by natural gas, methane gas, liquefied petroleum gas, alcohol fuel, or any other power source with equivalent or less air emissions than those power sources.

The bill requires that the allowable credit amount be reduced by the amount of any grant received from a governmental agency for the purchase of a new, or alteration, modification, or remanufacture of an existing, qualified generator.

The bill specifies the proposed credit shall only be allowed with respect to a generator that is operated and maintained in compliance with local and regional air quality standards.

This bill specifies that any deduction allowed for the same expenses for which the credit was allowed be reduced by the allowable credit amount.

This bill specifies that any credit in excess of the taxpayer's tax liability would first be credited against other amounts due, and the balance, upon appropriation by the Legislature, would be refunded to the taxpayer. In the absence of an appropriation to fund the refundable portion of the credit, any credit balance would be carried over to reduce tax liability in the succeeding years until exhausted.

This bill would include the dairy farm electric generator refundable credit in the list of credits that can reduce regular tax below tentative minimum tax (TMT) for purposes of the alternative minimum tax (AMT) calculation.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill specifies that in the absence of an appropriation to fund the refundable portion of the credit that in lieu of a refund, any credit balances would be carried over to reduce future tax liability. This provision would create inequitable treatment among taxpayers and result in additional contacts to the department, which would likely increase departmental costs.

The bill requires that the operation and maintenance of the generator comply with local and regional air quality standards to qualify for the credit. Taxpayers and department staff do not have independent expertise in the area of generators and thus may have difficulty determining whether the generator complies with this requirement. Requiring independent expert verification of the property and its compliance with this requirement would aid the department in administering this credit, perhaps in the form of an advance and/or ongoing certification requirement by a state, local or regional agency with the necessary expertise.

The bill specifies that the generator must "provide electric service onsite." However, no standard is specified to determine whether a taxpayer has complied with this requirement. Also, the bill does not require the dairy farm to actually cease receiving power from the grid to qualify for this credit. Clarification is needed on these points to ensure that the legislative intent is achieved.

The bill specifies the credit would only be allowed for the taxable year in which the generator is "first put into operation." However, "first put into operation" is not defined. The author may wish to use "first placed in service" which is used in other California credits (i.e., Manufacturers Investment Credit (MIC)). Differences in terminology could lead to disputes with taxpayers and would complicate the administration of the credit.

The bill does not provide for the recapture of the credit if the generator is sold or is no longer used within a specified time period. Since the bill does not require actual use of the generator for a specified period, it is theoretically possible for taxpayers to resell these generators among themselves and generate multiple credits in multiple tax years.

A large number of taxpayers lease certain items of property rather than purchase them. This credit would not be available to any taxpayer that leases a "dairy farm electric generator" for use in this state where the user is not the tax owner of the generator. However, the bill does not prevent the taxpayer that purchases a dairy farm electric generator and leases it to another taxpayer in this state from claiming the credit.

This bill leaves unclear whether taxpayers that are pass-through entities (partnerships and S corporations) could claim the credit and receive the refund, or whether the entity must pass through the entire credit to the investors (partners and shareholders), or whether FTB would be required to refund the credit amount in some fashion to both the entity and the investors. For ease of implementation, this bill should specify that the entire credit amount shall be refunded to the entity that incurred the expenses for the generator.

Since the proposed credit is refundable, the credit would need to be shown in the payment section on all personal income tax (PIT) returns that could be used to claim the credit. This would increase PIT return Forms 540, 540NR, and 540X by one page. Adding a page to these forms would result in a significant impact on FTB's operations and costs, would slow return processing, and would increase the amount of return storage space. The department would work within available space to the extent possible; however, the department may be required to lease additional office and file storage space.

TECHNICAL CONSIDERATIONS

Amendment 1 is provided to correct a reference.

LEGISLATIVE HISTORY

SB 16X (Soto, 2001/2002), as amended April 30, 2001, was identical to this bill. SB 16X died in Senate Revenue and Taxation Committee when the first extraordinary session was terminated.

OTHER STATES' INFORMATION

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

Massachusetts, Michigan, and *New York* do not provide a tax credit comparable to the credit proposed in this bill. The following is a brief list of incentives provided for energy conservation by the comparison states.

Massachusetts has an extensive program of tax exemptions and credits designed to encourage the consumption and production of energy efficient systems and alternative energy systems. These tax benefits include the following: individuals are allowed a credit for the purchase and installation of solar or wind energy systems for their residence; and businesses are allowed a deduction for the purchase and installation of solar and wind energy systems for heating, air conditioning, or water heating purposes.

Michigan does not generally provide energy conservation incentives through the tax system but uses an extensive system of grant and loan incentives to encourage investment in alternative energy and energy conservation.

New York has programs designed to affect both the consumption and the production of energy conservation systems and alternative energy equipment. Individuals are allowed a credit equal to 25% of certain solar electric generating expenditures.

FISCAL IMPACT

The department's costs to administer this bill are estimated to be $530,000 for fiscal year 2001-02. It is estimated that this bill would require the department to incur five additional personnel years (PYs) in 2001-02 to process and administer this credit. Amendment 2 is provided to suggest language for an appropriation to fund these departmental costs.

The estimated costs are associated with the printing and processing of the additional page to each return, changes to the computer systems, increased taxpayer telephone calls and correspondence, and electronic and paper storage.

Costs have not been determined at this time for an undetermined number of PYs for fraud investigators that may be required to verify this credit.

ECONOMIC IMPACT

Tax Revenue Estimate

This bill would result in revenue losses as follows:

Estimated Revenue Impact of SB 16XX As Introduced May 17, 2001 $ Millions		
2001-02	2002-03	2003-04
-$10	-$25	-$25

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

The estimates are based on the following information. There are about 2,200 dairy farms in California. Contacts with industry experts indicated that presently a large number of dairies have backup generators. A depreciable life of 15 years was assumed for these existing generators. Replacement of the existing generators would result in tax credits that are offset by the deductions that the farmers would claim in the absence of the proposed credit. For other dairy farmers a significant incentive effect to purchase generators due to the refundable credit was added. An average price and installation cost of $30,000 was assumed for the above purchases.

ARGUMENTS/POLICY CONCERNS

Historically, refundable credits (such as the prior state renter's credit and the federal Earned Income Credit) have had significant problems with invalid and fraudulent returns. These problems are aggravated because a refund that is later determined to be fraudulent commonly cannot be recovered.

This 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.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 16XX
As Introduced May 17, 2001

AMENDMENT 1

On page 4, line 18, strike out "17052" and insert:

17052.5

AMENDMENT 2

On page 12, line 36, following "SEC. 6." insert:

(a) There is hereby appropriated from the General Fund for expenditure in the 2001-2002 fiscal year the sum of five hundred thirty thousand dollars ($530,000) for allocation to the Franchise Tax Board in augmentation of Item 1730-001-0001 of the Budget Act of 2001.
(b) Funds allocated pursuant to subdivision (a) shall be expended by the Franchise Tax Board solely for the purposes of administration of the Dairy Farm Electric Generator Refundable Credit, pursuant to Sections 17053.83 and 23683 of the Revenue and Taxation Code, as added by this act.
SEC. 7.