

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Nakanishi Analyst: Victoria Favorito Bill Number: AB 154
Related Bills: See Legislative History Telephone: 845-3825 Introduced Date: January 18, 2007
Attorney: Dan Biedler Sponsor: _____

SUBJECT: Energy Efficient Commercial Building Costs Deduction Conformity

SUMMARY

This bill would conform California income tax law to the federal law permitting a deduction for the cost of energy efficient commercial buildings.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage construction of energy efficient commercial buildings.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current Federal Law

A deduction is allowed to a taxpayer for part or all of the cost of energy efficient commercial building property that the taxpayer places in service after December 31, 2005, and before January 1, 2008. This tax incentive was enacted as part of the Energy Policy Act (EPACT) of 2005 (PL 109-58).

Board Position:

_____ S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA X PENDING

Department Director

Date

Selvi Stanislaus

3/12/07

Energy-efficient commercial building property is defined as:

- property that is depreciable at cost;
- property installed on or in any building located in the United States that is within the scope of Standard 90.1-2001;¹
- interior lighting systems, heating, ventilation, and air conditioner systems (HVAC), hot water systems, and building envelope features; and
- property certified as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, HVAC systems, and hot water systems of the building by 50% or more in comparison to a reference building that meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003) using methods of calculation that satisfy the energy-saving targets established under the EPACT provision.

The deduction is equal to the amount of energy-efficient commercial building property expenditures made by the taxpayer, subject to a cap. The cap limits the deduction to an amount equal to \$1.80 per square foot of the property for expenditures made. The deduction is allowed in the year the property is placed in service. For tax purposes, "placed in service" generally means the time the property is ready for its intended use. If a deduction is allowed, the basis of the property is reduced by the amount of the deduction, and the remaining asset value is depreciated over its tax life for the class of property.

A partial deduction is allowed for buildings that do not meet the overall building requirement of 50% energy savings. The deduction for such buildings is up to \$.60 per square foot for each of three sub systems: the interior lighting system; the HVAC and hot water system; and building envelope system.

The owner of the energy efficient property is allowed to take the deduction. For buildings constructed on government property, the person primarily responsible for designing the property is treated as the taxpayer.

Current California Law

Current California law has no provision allowing a special expensing deduction relating to the cost incurred for energy efficient commercial building property. The expenses to acquire a commercial building and any improvements are recovered through depreciation deductions over the useful life of the building.

California corporation tax law has not conformed to the federal law using Modified Accelerated Cost Recovery System (MACRS) depreciation. California conforms to the federal basis rules of general application, but applies some modifications for state purposes.

¹ Energy standard for buildings except low-rise residential buildings set forth by the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (ASHRAE/IESNA).

THIS BILL

This bill would conform the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL) to the federal EPACT special expensing deduction for energy efficient commercial building property.

This bill would allow a deduction of an amount up to \$1.80 per square foot if over all energy use of the building is reduced by at least 50% in comparison to a reference building that meets the minimum requirements of Standard 90.1-2001. A partial deduction of up to \$.60 per square foot would be permitted for buildings that fall under the 50% overall reduction in energy use.

This bill would reduce the basis for the energy efficient commercial building property placed in service after 2005 and before 2008 by the amount of the deduction that would be allowed under this bill.

This bill would allow the deduction for commercial buildings placed in service in California and in other states.

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 current bill language has not incorporated recent EPACT changes to related IRC provisions regarding energy efficient commercial building properties, namely rules specifying : 1) the recapture of gain when property is sold or exchanged , 2) treating the amounts paid for energy-efficient commercial property as an exception to the general capital expenditure rule, and 3) the computation of earning and profits. It is recommended that this bill does conform to these federal changes. The absence of these defined rules could lead to disputes between the taxpayer and the department that would complicate administration of this deduction.

TECHNICAL CONSIDERATIONS

For clarity, the author may consider adding the EPACT section number (1331) referencing the energy efficient commercial buildings deduction. Amendments 1 and 2 are provided.

LEGISLATIVE HISTORY

AB 155 (Nakanishi 2007/2008) creates comparable state tax incentive for constructing energy efficient residential buildings. That bill is currently awaiting assignment by the Assembly Rules Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, Massachusetts, Michigan, Minnesota, and New York conform to EPACT, which allows an election to expense the cost of energy efficient commercial building property.

Florida corporate tax conforms to the federal change of expensing the cost of energy efficient commercial building property. *Florida* does not have a personal income tax.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the PIT and Corporation Tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 154 As Introduced On January 18, 2007 Effective On Or After January 1, 2007 Enactment Assumed After June 30, 2007			
Energy Efficiency	2007-08	2008-09	2009-10
Deduction	-\$2 Million	-\$250,000	-\$250,000

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

Revenue Discussion

Revenue estimates were pro-rated from federal projections for this provision in Title XIII, Energy Policy Act of 2005.

LEGISLATIVE STAFF CONTACT

Victoria Favorito
Franchise Tax Board
(916) 845-3825
victoria.favorito@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

Analyst Victoria Favorito
Telephone # (916)845-3825
Attorney Dan Biedler

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB/AB
As Introduced/Amended

AMENDMENT 1

SECTION 1. Section 17257 is added to the Revenue and Taxation code, to read:

17257. Section 179D of the Internal Revenue Code, as amended by Section 1331 of Title XIII of the Energy Policy act of 2005 (Public Law 109-58), relating to energy efficient commercial buildings, shall apply, except as otherwise provided.

AMENDMENT 2

SEC.2. Section 24356.2 is added to the Revenue and Taxation Code to read:

24356.2 Section 179D of the Internal Revenue Code, as amended by Section 1331 of Title XIII of the Energy Policy Act of 2005 (Public Law 109-58), relating to energy efficient commercial buildings, shall apply, except as otherwise provided.