Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nakanishi	Analyst:	Jennifer Bettencourt	Bill Number:	AB 155
Related Bills:	See Legislative History	Telephone:	845-5163	Introduced Date:	January 18, 2007
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT: Energy Efficient Home Refundable Credit

SUMMARY

This bill would allow a refundable tax credit for the purchase or construction of a qualified energy efficient home.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to promote the construction of energy efficient homes that are expected to produce substantial energy cost savings and a reduction in energy requirements.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2008.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Current federal law, in accordance with the Energy Policy Act of 2005, allows a new energy efficient home credit for an eligible contractor. An eligible contractor is:

- the person who constructed the qualified new energy efficient home, or
- the manufactured home producer of such home, in the case of a qualified new energy efficient home that is a manufactured home.

The credit is allowed for each qualified new efficient home and is based on the energy saving requirements of the home. Site-built homes qualify for a $2,000 credit if they reduce energy consumption by 50% relative to the International Energy Conservation Code (IECC) standard. Manufactured homes qualify for a $1,000 or $2,000 credit, depending on the level of energy savings achieved. Taxpayers may carry forward any unused credit for up to 20 years.

Board Position:			Department Director	Date
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Each qualified new energy efficient home must be a dwelling unit:

- located in the United States,
- substantially completed after August 8, 2005, and before December 31, 2008, and
- certified as meeting the energy savings requirements prescribed by the Secretary of Energy.

Certification must be in writing and must be obtained from the Secretary of Energy. The Secretary of Energy will provide specific procedures and methods for calculating energy and cost savings. The certification must specify the energy efficient building envelope components and energy efficient heating or cooling equipment installed and their respective rated energy efficient performance.

Current state law allows a tax deduction for interest paid or incurred on a public utility company financed loan that is used to purchase and install energy efficient equipment or products, including zone-heating products for a qualified residence located in California.

Existing state laws provide various credits for personal income tax that reduce the tax and have either refundable or carryover provisions. Corporate tax laws (CTL) provide various credits that reduce the tax and in many instances have carryover provisions. Generally, these credits are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

THIS BILL

For taxable years beginning on or after January 1, 2008, this bill would provide a credit for a qualified taxpayer, as defined, for the construction or acquisition of a qualified energy efficient home.

This bill would define "qualified taxpayer" as either an eligible contractor or a person who acquired or purchased a qualified energy efficient home from an eligible contractor. It would define "eligible contractor" as a person who constructs or manufactures a qualified energy efficient home.

The credit is allowed for a dwelling unit that must be certified as an energy efficient home, as follows:

A $2,000 credit is allowed for dwelling units that meet the following requirements:

- Have a level of annual heating and cooling energy consumption that is at least 50% below the annual level of heating and cooling energy consumption of a comparable dwelling unit,
- Have building envelope component (i.e., exterior walls, floor, roof) improvements that account for at least 1/5 of the 50% reduction in energy consumption,
- Are constructed in accordance with the standards of Chapter 4 of the 2003 International Energy Conservation Code, as that code is in effect on January 1, 2008,
- Contains the minimum heating and cooling equipment efficiencies pursuant to the National Appliance Energy Conservation Act of 1987, as it is in effect at the time of completion, and
- Conforms to Section 3280 of Title 24 of the Code of Federal Regulations, if the dwelling is a manufactured home.

A $1,000 credit is allowed for dwelling units that meet the following conditions:

- The dwelling unit is a manufactured home,
- Conforms to Section 3280 of Title 24 of the Code of Federal Regulations, and
- Meets either of the following:
    - Has a level of annual heating and cooling energy consumption that is at least 30% below the annual level of heating and cooling energy consumption of a comparable dwelling and has envelope component improvements that account for at least one-third of the 30% reduction in energy consumption, or
    - Meets the requirements established by the Administrator of the United States Environmental Protection Agency under the Energy Star Labeled program.

This bill would specify that any excess credit amount that remains, after applying the credit against any other amounts due, would be refunded to the taxpayer.

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.

- This bill would allow a credit to both the eligible contractor and the person who acquires or purchases a qualified energy efficient home from an eligible contractor. Unless the author's intent was to allow duplicate credits to be claimed (this would differ from the federal credit), amendments are necessary to clarify that only a single credit could be claimed per structure.
- This bill requires a dwelling unit to be certified to qualify for the credit, but fails to designate a certifying agency. To provide the department a method to verify certification, the author may wish to amend the bill to clearly specify a state certifying authority or require adoption of the federal method of certification.
- Creating a refundable credit for entities subject to tax under Part 11 of the Revenue and Taxation Code would be unprecedented. As a result, the department's corporation processing systems would need to be significantly modified. It is expected that the department costs associated with these system programming changes would be substantial.
- The existing ordering rules for application of credits under personal income tax (PIT) law requires that credits be applied to tax in the following order:
    1. Refundable credits
    2. Credits that do not contain carryover or refundable provisions
    3. Credits with carryover provisions, but no refundable provisions

Because the CTL lacks a provision for refundable credits, the author may wish to amend this bill to add a provision in the CTL that specifies the order corporate tax credits are to be applied against the net tax.

- Under current law, credits cannot reduce the alternative minimum tax and the $800 minimum franchise tax. However, the practical effect of making the credit refundable would be to allow the credit to offset the minimum franchise tax and the corporate alternative minimum tax.
- This bill is unclear for taxpayers that are pass through entities (partnerships, limited liability companies, and S corporations) whether they could claim the credit and receive a refund or pass the entire credit to their investors (partners and shareholders) or both the entity and their investors would be entitled to a refund of the credit amount.

This bill contains provisions that are very similar to the new federal energy efficient home credit. General state tax policy promotes conformity to federal law wherever possible. Many of the department's implementation concerns, which are generally traceable to incomplete or missing definitions and related concerns, could be resolved if the federal credit provisions were adopted by reference, with appropriate modifications where the author's intent differs from the federal credit provisions. In addition, this "federal conformity with modifications" approach has the benefit of allowing the department and taxpayers to follow, where appropriate, federal administrative pronouncements interpreting the federal credit provisions for purposes of administering this credit.

LEGISLATIVE HISTORY

AB 154 (Nakanishi, 2007/2008) would authorize, in conformity with federal law, a taxpayer who placed an energy efficient commercial building in service during the taxable year to deduct an amount equal to the cost of the building, subject to specified restrictions. This bill is scheduled for hearing with the Assembly Revenue and Taxation Committee on March 12, 2007.

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.

The owner of residential property located in *Massachusetts* is entitled to a one-time credit against personal income tax for all energy efficient heating items purchased on or after November 1, 2005, but not later than March 31, 2006 for installation in the property. The credit is equal to 30% of the cost of the products up to $600 for a single-family home and up to $1,000 for a multi-unit dwelling. The credit may be taken in the taxable year 2005 or 2006 in which any qualifying purchase was made.

Michigan allows a home energy efficiency improvement tax credit for taxpayers who purchase and install specific products, such as energy-efficient windows, insulation, doors, roofs, and heating and cooling equipment in the home. Taxpayers can receive a tax credit of up to $500 beginning in January, 2006. In addition, businesses are eligible for tax credits for building energy-efficient buildings and improving the energy efficiency of commercial buildings (as outlined in the Energy Policy Act of 2005).

A comparable credit was not found for *Florida, Illinois, Minnesota, or New York.*

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 155 Effective On Or After January 1, 2008 Enactment Assumed After June 30, 2007 ($ in Millions)			
2007-08	2008-09	2009-10	2010-11
-$10	-$55	-$70	-$90

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

Revenue Discussion:

Based on conversations with industry sources, it is projected that 10,000 qualifying stick-built homes would be built in 2008 and 15,000 in 2009. It is estimated that less than 5% of new manufactured homes would qualify for the $1,000 credit allowed under this bill and would have a minimal revenue impact. The credit amount of $2,000 was used to figure the total impact of $20 million (10,000 homes x $2,000 credit). As written, both the builder and the purchaser of the home qualify for the credit ($4,000 per house). The total credit for 2008 would be $40 million ($4,000 x 10,000 homes). The estimate above has been adjusted to reflect fiscal years. The table above assumes that 25% of the 2008 credit would impact 2007-08 and the remaining in 2008-09. Estimates were rounded.

ARGUMENTS/POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review by the Legislature to determine the effectiveness of a credit.

LEGISLATIVE STAFF CONTACT

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