Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Arambula	Analyst:	Nicole Kwon	Bill Number:	AB 1651
Related Bills:	See Prior Analysis	Telephone:	845-7800	Amended Date:	January 7, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Qualified Capital Greenhouse Gas Emissions Reduction Equipment Credit

_X_ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended May 10, 2007.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 10, 2007, STILL APPLIES.

____ OTHER – See comments below.

SUMMARY

This bill would create a tax credit for qualified capital equipment used to reduce greenhouse gas emissions.

SUMMARY OF AMENDMENTS

The January 7, 2008, amendments would make various changes, including adopting some of the technical amendments proposed by the department's analysis of the bill as amended May 10, 2007.

Specifically, the amendments would do the following:

- Change the definition of "measurable reduction in the greenhouse gas emissions" to mean a reduction in the greenhouse gas emissions of the facility by more than five percent, as certified by either the California Climate Action Registry or the State Air Resources Board.
- Change the definition of "qualified taxpayer" to mean a taxpayer that satisfies all of the following requirements:

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	5/28/08
____ N	____ OUA	_X_ PENDING		

- Has fewer than 150 employees, including the employees of any of the taxpayer's affiliates,
- Average annual gross receipts over the last three taxable years are $10 million or less, and
- Reports its greenhouse gas emissions, on either a voluntary or a mandatory basis, to the California Climate Action Registry or the State Air Resources Board.

As a result of these amendments, the "This Bill," "Technical Considerations," and "Economic Impact" discussions have been revised and are provided below. The department's previous analysis of the bill as amended on May 10, 2007, continues to apply.

POSITION

Pending.

ANALYSIS

<u>THIS BILL</u>

This bill would provide credits for each taxable year beginning on or after January 1, 2008, and before January 1, 2013, based on the following percentages for amounts paid or incurred for qualified capital equipment under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL):

- 15% of the amount paid or incurred for qualified capital equipment for taxable years beginning on or after January 1, 2008, and before January 1, 2010.
- 8% of the amount paid or incurred for qualified capital equipment for taxable years beginning on or after January 1, 2010, and before January 1, 2012.
- 3% of the amount paid or incurred for qualified capital equipment for taxable years beginning on or after January 1, 2012, and before January 1, 2013.

This bill would define "qualified capital equipment" to meet <u>all</u> of the following:

1. Tangible personal property as defined in IRC section 1245(a)(3)(A) and is for use by a qualified taxpayer in a qualified activity.
2. Newly constructed or fabricated.
3. Used exclusively in California by the taxpayer.
4. Certified by the California Climate Action Registry or the State Air Resources Board that it has been properly installed in a qualified facility and is operational.
5. Certified by the California Climate Action Registry or the State Air Resources Board that its operation will result in measurable reductions in greenhouse gas emissions.
6. Produces an eligible greenhouse gas reduction.
7. The original use of the equipment commences with the taxpayer.

This bill would define “qualified cost” to mean any cost that meets all of the following:

1. A cost paid or incurred by the taxpayer for the construction or purchase, including installation costs of qualified capital equipment on or after January 1, 2008, and before January 1, 2013.
2. Any amount upon which the taxpayer has paid, directly or indirectly as a separately stated contract amount or as determined from the records of the taxpayer, California sales or use tax.
3. An amount properly charged to the capital account of the taxpayer.

This bill would define the following terms:

- “Capitalized labor cost” means costs for labor directly allocable to the construction or installation of qualified capital property that is properly charged to the capital account of the taxpayer.
- “Measurable reduction in the greenhouse gas emissions” to mean a reduction in the greenhouse gas emissions of the facility by more than five percent, as certified by either the California Climate Action Registry or the State Air Resources Board
- “Greenhouse gas emission” has the same meaning as defined in the Health and Safety Code, section 38505(g).
- “Purchase” means any transaction that is treated as a sale for sales and use tax purposes.
- “Qualified taxpayer” to mean a taxpayer that satisfies all of the following requirements: (1) has fewer than 150 employees, including the employees of any of the taxpayer’s affiliates, (2) average annual gross receipts over the last three taxable years are ten million dollars ($10,000,000) or less, and (3) reports its greenhouse gas emissions, either on a voluntary or a mandatory basis, to the California Climate Registry or the State Air Resources Board.

This bill would provide a carryover provision for unused credits for eight years.

This bill would provide a repeal date of December 31, 2013.

TECHNICAL CONSIDERATIONS

Technical amendments are necessary and are provided.

ECONOMIC IMPACT

Revenue Estimate**:**

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB1651 As Amended 1/07/08 ($ in Millions)		
2008-09	2009-10	2010-11
-$30	-$60	-$60

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

Revenue Discussion

Previous revenue estimates for the May 10, 2007, amendments were based on data from the Annual Survey of Manufacturers for 2005. For this bill, estimates are based on data from the Survey of Annual Capital Expenditures for 2006. Rather than being limited to manufacturers, the survey of capital expenditures includes expenditure data for all industries.

The revenue impact of this bill would be determined by the amount of qualified costs in excess of standard costs for qualified capital equipment and the amount of credits that qualified taxpayers can apply to reduce tax liabilities.

According to the Survey of Annual Capital Expenditures, businesses spent $819.1 billion on new and used machinery and equipment in 2006. The $819.1 billion includes capitalized labor costs related to construction or installation of machinery and equipment. For purposes of an estimate for this bill, California's share of this investment is assumed to be 10%, or $81.9 billion ($819.1 billion x 10%). This level of investment for 2006 is grown to years 2008 through 2011 by the projected growth in corporate profits as forecasted in the Governor's budget. At the 2008 level, the investment is estimated at $91.3 billion of which approximately 95% is new machinery and equipment, or approximately $86.5 billion ($91.3 billion x 95%).

For purposes of an estimate, it is assumed that one-eighth, or 12.5%, of the $86.5 billion is for qualified capital equipment as specified in this bill, or $10.8 billion ($86.5 billion x 12.5% = $10.8 billion). It is assumed that qualified equipment is stationary and not mobile. A series of adjustments is necessary to determine how much of the $10.8 billion is eligible for the proposed credit. A qualified taxpayer is an individual or entity that meets the following requirements: (1) has fewer than 150 employees, (2) total annual gross receipts of $10 million or less, and (3) reports greenhouse gas emissions on a voluntary or mandatory basis. Tax return data indicates that 93% of corporations have annual gross receipts of $10 million or less.

Based on this data, it is assumed that approximately 90% of these firms have fewer than 150 employees. Although the vast majority of business entities have gross receipts of $10 million or less and fewer than 150 employees, it is assumed that the level of investment by qualified taxpayers is only 20% of the total investment by all business entities, or $2.2 billion ($10.8 billion X 20%). Currently, all greenhouse gas emission reporting is on a voluntary basis. It is assumed that 33% of the $2.2 billion of qualified capital equipment would be voluntarily reported and eligible for the credit in 2008, or approximately $725 million ($2.2 billion x 33% = $725 million).

The credit is limited to an amount in excess of “standard costs” for equipment required to meet existing law or regulations. The State Air Resources Board has indicated that “standard costs” are unlikely to be established before 2011. Until the State Air Resources Board establishes “standard costs,” it is assumed that excess of standard costs is 100% of qualified costs.

For 2008, applying the credit percentage of 15% to $725 million results in credits generated of approximately $108 million ($725 million x 15% ≈ $108 million). It is assumed that 50% of credits generated would be applied in the year generated, or $54 million for the 2008 taxable year. Carryover credits are assumed applied ratably over the succeeding five years. Taxable year estimates are converted to the cash flow fiscal year estimates in the table.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1651
As Amended January 7, 2008

AMENDMENT 1

On page 2, line 32, after "Climate Registry", insert:

Action

AMENDMENT 2

On page 5, line 13, after "Climate Registry", insert:

Action