Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Alquist | Analyst: Nicole Kwon | Bill Number: SB 1484

Related Bills: See Prior Analysis | Telephone: 845-7800 | Amended Date: May 6, 2008

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Clean Energy Technology Credit/Disallow Credits And Deductions To Taxpayers Engaged In Oil Production Business For Taxable Years Beginning On And After January 1, 2011

__X__ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended March 28, 2008.

__X__ 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 March 28, 2008, STILL APPLIES.

_____ OTHER – See comments below.

SUMMARY

This bill would create a credit for certain taxpayers for qualified equipment relating to clean energy technology and disallow credits and other incentives for taxpayers engaged in the business of oil production.

SUMMARY OF AMENDMENTS

The May 6, 2008, amendments would make various changes, including adopting certain implementation and technical amendments proposed by the department's analysis of the bill as amended March 28, 2008.

Specifically, the amendments would do the following:

- Limit the amount of credit to $10 million per taxpayer per year with the aggregate credit limit for all taxpayers of $30 million for any taxable year.
- Remove the sunset date for the credit related to clean energy technology.

Board Position:			Asst. Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Patrice Gau-Johnson	5/9/08
_____ N	_____ OUA	__X__ PENDING		

- Require the Public Utilities Commission to regulate and certify a taxpayer for "qualified amount."
- Limit the carryover period for the credit to eight years.
- Require the clean energy technology equipment to remain in California for two years with a 50% recapture provision if the property is removed before meeting the two-year period requirement.
- Revise the definition of "clean energy technology."
- Require the qualified taxpayer to be a manufacturer of clean energy technology for not more than five years, with the Public Utilities Commission administering the required time limit.
- Revise the definition of "qualified taxpayer."
- Revise the repeal dates of credits and other incentives for taxpayers engaged in the business of oil production to January 1, 2011.

As a result of the amendments, the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," "Fiscal Impact," "Economic Impact," and "Policy Concerns" discussions have been revised and are provided below. The department's previous analysis of the bill as amended on March 28, 2008, continues to apply.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The clean energy technology credit would be specifically operative for taxable years beginning on or after January 1, 2011. Certain provisions of existing law are repealed as of January 1, 2011, which would be operative for taxable years beginning on or after that date. Other provisions cease to apply for taxpayers engaged in the business of oil production for taxable years beginning on or after January 1, 2011.

POSITION

Pending.

<u>THIS BILL</u>

This bill would provide a credit for taxable years beginning on or after January 1, 2011, in an amount equal to 50% of a qualified amount, as defined, for clean energy technology equipment. This credit would be limited to $10 million per taxpayer per year with the aggregate credit limit that may be allocated to all qualified taxpayers of $30 million for any taxable year.

This bill would define "clean energy technology" to mean any renewable energy technology, or energy supply, or end-use technology whose electrical efficiency is at least 40% higher heating value as determined by the Public Utilities Commission.

This bill would define “qualified amount” to mean the total amount paid or incurred by the qualified taxpayer for either of the following:

- New machinery, equipment, or new devices, or any addition to, reconstruction of, or improvement of, new machinery, equipment, or devices that are acquired, constructed, or installed in connection with the processing or manufacturing of clean energy technology, as certified by the Public Utilities Commission, that are located and remain within California for a period of two years from the date placed in service, or
- Capital investments in a qualified facility.

This bill would define “qualified facility” to mean a facility that meets both of the following:

1. The qualified taxpayer has provided the California Energy Commission with all the pertinent information needed to certify the facility and remitted any certification fees to the California Energy Commission, and
2. The California Energy Commission has certified the facility as a facility where all of the processed or manufactured items are clean energy technology.

This bill would define “qualified taxpayer” to mean a taxpayer engaged in the business of the processing or manufacture of clean energy technology products for a period of not more than five years, as certified by the Public Utilities Commission.

This bill would require the Franchise Tax Board (FTB) to promulgate rules and regulations necessary to establish procedures, processes, requirements, and rules required to implement the provisions of this bill.

This bill would allow the carryover of the unused credit for eight years.

This bill would make the following changes to certain incentives under current law:

- For taxable years beginning on or after January 1, 2011, a taxpayer engaged in the business of oil production would no longer be eligible for the qualified research and development credit (R&D).
- The enhanced oil recovery credit would be repealed as of January 1, 2011.
- For taxable years beginning on or after January 1, 2011, the deduction for intangible drilling and development costs (IDC) would no longer apply to taxpayers engaged in the business of oil production.
- For taxable years beginning on or after January 1, 2011, a taxpayer engaged in the business of oil production would no longer be eligible for the depletion deduction allowed under current state law.

IMPLEMENTATION CONSIDERATIONS

The term "engaged in the business of oil production" in this bill is unclear and undefined. To prevent disputes between taxpayers and the department, the department recommends that the term be defined.
The term "capital investments" in this bill is unclear and undefined. To prevent disputes between taxpayers and the department, the department recommends that the term be defined.

This bill indicates an aggregate credit allocation amount of $30 million for each taxable year. However, the bill is silent on who would administer the allocation. Prior to being claimed on a franchise or income tax return, the credit provided in this bill should be allocated by a designated agency. The department currently does not have a mechanism for allocation of any tax credits. Without a designated agency administering the allocation of credit, the department would need to examine returns claiming a credit as provided by this bill, and such examinations would be lengthy, complex, and costly. In addition, taxable years vary from taxpayer to taxpayer and allocations are done on the basis of a calendar year or the state's fiscal year. The author may want to amend the bill to mirror the current law of the low-income housing credit and the natural heritage preservation credit, both of which are allocated by a designated agency and to indicate that credit allocation amount applies for the 2011 calendar year, and each calendar year thereafter.

This bill requires the FTB to promulgate rules and regulations necessary to establish procedures, processes, requirements, and rules required to implement the provisions of this bill. To assist in administering the provisions of this bill, the author may want to expand and give the same type of authorities to the Public Utilities Commission and the California Energy Commission.

TECHNICAL CONSIDERATIONS

Technical amendments are necessary and are provided.

FISCAL IMPACT

If this bill is amended to resolve the Implementation and Technical Considerations addressed in this analysis, the department's costs are expected to be minor. However, if FTB would be required to audit returns claiming the credit as provided by this bill, these examinations would be lengthy and complex. The cost to conduct such audits would be substantial.

ECONOMIC IMPACT

Revenue Estimate

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

Revenue Impact of SB 1484 As Amended May 6, 2008 Enactment Assumed After June 30, 2008 ($ in Millions)			
	2010-11	2011-12	2012-13
Clean Energy Technology Credit	–$15	–$45	–$35
Repeal of R&D credit for Oil Companies	Gain of less than +$0.15	Gain of less than +$0.15	Gain of less than +$0.15
Repeal of Intangible Drilling Cost Deduction	+$5	+$15	+$20
Repeal of Percentage Depletion Deduction	+$5	+$20	+$20
Total	-$5	-$10	+$5

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure. The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years. Detail may not add to totals due to rounding.

Revenue Discussion

According to the Census Bureau, the total amount of capital expenditures on new equipment in 2006 was $775 billion. This bill would limit the definition of a qualifying taxpayer. Therefore, the estimates would eliminate capital expenditures incurred by industries that would insignificantly affect energy savings. For example, these industries could include finance and insurance, educational services, arts, entertainment, recreation, and other similar industries. The elimination of these industries would result in a net capital expenditure of approximately $460 billion. Applying the projected corporate profit growth rates from the Governor’s Budget, this amount would increase to approximately $570 billion in 2011.

Clean Energy Technology Credit:

According to the Census Bureau, the amount of 2005 spending on pollution abatement technologies was approximately 1% of total capital expenditures. Due to the incentive of allowing a credit provided in this bill, it is assumed that this ratio would increase to 3%. Based on this assumption, the amount spent on clean-energy technologies would be approximately $17 billion ($570 billion x 3%). For purposes of an estimate for this bill, it is assumed that California’s share would be 10% or $1.7 billion ($17 billion x 10%).

With a credit equal to 50% of the qualified costs related to clean energy technology, this amount would be reduced to approximately $855 million. It is further estimated that only 75% of this amount ($855 million x 75% ≈ $640 million) can be claimed due to the $10 million per taxpayer limitation specified in this bill. It is also estimated that only 50% of this amount or approximately $321 million can be claimed due to sufficient tax liability. This $321 million is the total amount that could be applied in the absence of the $30 million aggregate credit limitation.

With the aggregate limitation, the total annual qualifying credits cannot exceed $30 million in a year. It is assumed that taxpayers whose income tax return claiming a credit is received prior to when the $30 million credit limit is reached can use 80% of this amount, ($30 million x 80% = $24 million), due to sufficient tax liability.

This bill does not specify how the $30 million limitation would be apportioned among different taxpayers. For the purpose of an estimate for this bill, it is assumed that initially individual taxpayers would not know if they are within the $30 million limitation. Therefore, each taxpayer would report an amount of credit up to $10 million per year. This would result in an additional loss of approximately $297 million ($321 million – $24 million) in 2011, in excess of the qualifying credits. It is assumed that the department would recapture 90% of this amount in the same fiscal year that the return is filed, 8% is the fiscal year following the fiscal year in which the return is filed, and 2% in the subsequent fiscal year. Unapplied qualifying credits are carried over to subsequent tax years and assumed applied over five years.

Enhanced Oil Recovery Credit:

The amount of enhanced oil recovery credit for 2011 is projected to be zero. For 2006 and later years, the “reference price” (the average per barrel wellhead price of domestic crude oil) of oil has exceeded $28 (as indexed for inflation) and thus this credit is completely phased out.

R & D Credit:

Based on a review of tax return data, the impact of the elimination of the R&D credit for oil companies is estimated to be very small revenue gain, less than $150,000 for each year.

IDC:

Based on the pro ration of federal numbers, the revenue gain from repeal of IDC is projected to be approximately $17 million for 2011.

Percentage Depletion Deduction:

Based on the pro ration of federal numbers, the repeal of percentage depletion deduction is estimated to raise $19 million of revenue in 2008. This amount is estimated to increase at the corporate profit growth rate in subsequent years reaching $20 million in 2011. These estimates include the effect of the repeal on the credits claimed by oil companies only and exclude natural gas and mineral companies.

Summary:

Including the amount that would be recaptured in subsequent years, the net effect of the provisions in this bill in 2011 would result in a revenue loss of $54 million ($24 million for allowed credit + $30 million for disallowed or repealed credit that would be recaptured over the next two years). The estimates in the table above are fiscalized and taken into account the recapture of credits by the department in subsequent years.

POLICY CONCERNS

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

This bill would disallow credits and other incentives for taxpayers engaged in the business of oil production. These provisions would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill would create a credit for certain taxpayers for qualified equipment relating to clean energy technology. Because the new credit does not include provisions that deny or reduce a deduction for the same expense, this new credit would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO SB 1484
As Amended May 6, 2008

AMENDMENT 1

On page 3, line 8, strikeout "2001" and insert:

2011

AMENDMENT 2

On page 6, line 12, after "New machinery", insert:

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AMENDMENT 3

On page 14, line 12, after "New machinery", insert:

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