Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Blumenfield	Analyst:	William Koch	Bill Number:	AB 1029
Related Bills:	See Legislative History	Telephone:	845-4372	Introduced Date:	February 27, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Solar Energy Materials Manufacturing Credit

SUMMARY

This bill would create a tax credit equal to an unspecified percentage of the cost to manufacture qualified solar energy materials.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to increase the availability of alternative energy sources.

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, 2009, and before January 1, 2011.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). Generally, these credits are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

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Current **federal law** allows an energy credit for taxpayers that place in service during the taxable year qualifying energy property.[1] Qualifying energy property includes equipment that uses solar energy to do the following:

- Illuminate the inside of a structure using fiber-optic distributed sunlight,
- Generate electricity,
- Heat or cool (or provide hot water for use in) a structure, or
- Provide solar process heat (but not to heat a swimming pool).

The federal energy credit for the solar energy property listed above is equal to 30 percent of the basis of the solar energy property. The credit is a component of the investment credit, which is part of the general business credit.

Existing **state law** lacks a comparable credit.[2]

Under current state law, for taxable years beginning on or after January 1, 2008, and before January 1, 2010, the total of all business credits otherwise allowable may not exceed 50 percent of the net tax of the taxpayer for that taxable year. Taxpayers with net business income of less than $500,000 are excluded from this limitation.

In addition, current state Corporation Tax Law allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an “eligible credit” may be assigned by a taxpayer to an “eligible assignee.”
    - “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008.
    - “Eligible assignee” means any “affiliated corporation” that is a member of a combined reporting group at certain specified times.
    - “Affiliated corporation” means a corporation that is a member of a combined reporting group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2009, and before January 1, 2011, this bill would provide a credit equal to an unspecified percentage of the amount paid or incurred during the taxable year by a taxpayer in connection with the manufacture of qualified solar energy materials.

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[1] Internal Revenue Code section 48

[2] For taxable years beginning on or after January 1, 2001, and before December 1, 2006, prior state law provided a tax credit for taxpayers who purchased a solar or wind energy system for installation and electrical generation in California.

This bill would do the following:

1. Define “manufacturing” as combining or processing components or materials to increase their value for sale in the ordinary course of business, excluding construction, farming, power generation, or processing natural resources.

2. Define “qualified solar energy materials” as materials used in solar energy systems that meet standards established by the California Energy Commission and are approved for use in the California Solar Initiative.

3. Provide the Franchise Tax Board (FTB) the authority to prescribe rules and regulations to carry out the purposes of this credit, including rules and regulations necessary to “prevent the avoidance of the effect” of this credit through “splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.”

4. Allow the credit to Personal Income Tax Law taxpayers and Corporate Tax Law taxpayers.

5. Allow unused credits to be carried over up to five years.

6. Repeal the credit as of December 1, 2011.

Because this bill does not indicate otherwise, the credit provided by this bill would be subject to the 50 percent limitation for the 2009 taxable year and could be assigned to other members of a combined reporting group.

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 fails to specify the credit percentage and maximum amount that would be available to a taxpayer for the costs paid or incurred in connection with the manufacture of qualified solar energy materials. Without specification, the department would be unable to administer this credit.

This bill also fails to specify what costs would qualify to be considered “in connection” with the manufacture of qualified solar energy materials. It is unclear if costs such as labor, equipment, administrative, and overhead would qualify. It is recommended the author amend the bill to clarify this issue.

This bill would define “qualified solar energy materials” as materials used in solar energy systems that meet standards established by the California Energy Commission and are approved for use in the California Solar Initiative. The department lacks the expertise to determine whether materials meet these requirements. Often credits requiring specialized expertise contain language that specifies an appropriate state agency for certification purposes. The author may wish to amend the bill to specify a certifying agency.

This bill would provide FTB the authority to prescribe rules and regulations to carry out the purposes of this credit, including rules and regulations necessary to “prevent the avoidance of the effect” of this credit through “splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.” The author may wish to amend the bill to specify the purposes of this credit and to elaborate on the phrase “prevent the avoidance of the effect” to facilitate the department’s promulgation of rules and regulations necessary to administer the provisions of this bill.

LEGISLATIVE HISTORY

AB 2849 (Ruskin, 2005/2006) would have extended the Solar or Wind Energy Credit to taxable years beginning on or before January 1, 2011. AB 2849 was held in the Assembly Revenue and Taxation Committee.

SB 1017 (Campbell, 2005/2006) would have extended the Solar or Wind Energy System Credit to taxable years beginning on or before January 1, 2017. SB 1017 was held in the Senate Revenue and Taxation Committee.

SB 1660 (Scott, Stats. 2002, Ch. 487) expanded the Solar Energy Credit to include wind energy systems and require certification of solar and wind energy systems by the State Energy Resources Conservation and Development Commission.

SBX2 17 (Brulte, Stats. 2001, Ch. 12) allowed a 15 percent Solar Energy Credit for the purchase and installation of a solar energy system on property in this state.

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. None of these states have a tax credit for the manufacture of solar energy materials.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department’s costs are expected to be minor.

ECONOMIC IMPACT

The revenue impact of this bill would be determined by the amount paid or incurred during the taxable year in connection with the manufacture of qualified solar energy materials, and by the applicable credit percentage. Because this bill does not specify a credit percentage, the revenue impact of the bill can not be determined at this time.

ARGUMENTS/POLICY CONCERNS

Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense or is otherwise reflected as an adjustment to the basis of property for tax purposes. Providing both a credit and allowing the full amount to be deducted (or added to basis) would have the effect of providing a double benefit for that item or cost. On the other hand, making an adjustment to deny the deduction or reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

Additionally, the credit would be allowed for expenses paid or incurred in connection with the manufacture of qualified solar energy materials whether manufactured inside or outside of California.

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