

ANALYSIS OF AMENDED BILL

Author: Melendez Analyst: Jessica Deitchman Bill Number: AB 585
 Related Bills: See Legislative History Telephone: 845-6310 Introduced & Amended Date: February 24 & March 16, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Outdoor Water-Efficiency Improvement Credit/Outdoor Water-Efficiency Act of 2015
-----------------	--

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow a tax credit for water-efficient improvements to outdoor landscapes.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The bill as introduced on February 24, 2015, would create a tax credit for certain water-efficient improvements.

The March 16, 2015, amendments modified the operative date of the bill and clarified the term “water efficiency”.

This is the department’s first analysis of the bill.

Summary of Suggested Amendments

Two technical amendments are provided to correct grammatical errors.

REASON FOR THE BILL

The reason for the bill is to incentivize taxpayers to purchase water efficiency improvements for use in outdoor landscapes to assist in the state’s efforts to increase the reliability of its water supplies.

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, 2015. This Section shall remain in effect until December 1, 2021, unless the drought state of emergency declared by the Governor on January 17, 2014, is terminated before the date, in accordance with Section 8629 of the Government Code. In the event, the section shall remain in effect only until midnight on the first day of the first calendar quarter commencing more than 60 days after the date of the termination of the state of emergency, or until December 1, 2021, whichever is earlier, and credits shall be allowed only for that portion of the taxable year before the date this section becomes inoperative.

Board Position:	Executive Officer	Date
_____ S _____ NA _____ X _____ NP	Selvi Stanislaus	4/22/15
_____ SA _____ O _____ NAR		
_____ N _____ OUA _____		

FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Existing state and federal 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). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current California law¹ requires, by January 1, 2019, that all noncompliant plumbing fixtures in multifamily residential real property and commercial real property be replaced with water-conserving plumbing fixtures.

Current state law allows an exclusion from gross income, under both the PITL and Corporation Tax Law (CTL), for amounts received as a rebate, voucher, or other financial incentive issued by a local water agency for participation in a turf removal water conservation program for taxable years 2014 through 2018.

Current state law lacks a comparable credit to the one that would be created by this bill.

THIS BILL

For taxable years beginning on or after January 1, 2015, and before January 1, 2021, this bill would, under the PITL, provide a tax credit of 25 percent of the amount paid or incurred during the taxable year by a qualified taxpayer for water-efficiency improvements for outdoor landscapes on qualified real property in this state, not exceed² \$2,500 per taxable year.

The bill would define the following phrases:

- “Multifamily residential real property” means any real property that is improved with, or consisting of, a building containing more than one unit that is intended for human habitation, or any mixed residential-commercial buildings or portions thereof that are intended for human habitation. Multifamily residential real property includes residential hotels but does not include hotels and motels that are not residential hotels.
- “Qualified real property” means either multifamily residential real property or single-family real property.
- “Qualified taxpayer” means the owner of any qualified real property.

¹ Civil law Code section 1101.4 and 1101.5.

² See technical amendment.

- “Single-family residential real property” means any real property that is improved with, or consisting of, a building containing not more than one unit that is intended for human habitation.
- “Water-efficiency improvement” means expenditures paid or incurred by the qualified taxpayer to meet the requirements of any of the following:
 - A local water-efficient landscape ordinance adopted or in effect pursuant to subdivision (c) of Section 65595 of the Government Code.
 - A local landscape regulation or restriction on the use of water adopted pursuant to Section 353 or Section 375 of the Water Code.
 - A water-efficient landscape program that is developed and implemented by a regional or local water agency for the specific purpose of reducing water use.

Section 41³ would not apply to the credit allowed by this bill.

The provision authorizing the credit would remain in effect until December 1, 2021 unless the drought state of emergency declared by the Governor on January 17, 2014, is terminated before that date.⁴ In that event, this bill would remain in effect only until midnight on the first day of the first calendar quarter commencing more than 60 days after the date of the termination of the state of emergency, and credits would be allowed only for that portion of the taxable year before the date this bill becomes inoperative.

This bill would be repealed on December 1, 2021.

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 lacks a certification process. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

Operative dates for tax credits are generally allowed on a taxable year basis. This bill would provide an operative date that would be based on a conditional event. This language creates ambiguity that would be impracticable to administer.

³ The R&TC section 41 requires any new tax credit legislation introduced on or after January 1, 2015, to include specific goals, purposes, objectives, and performance measures.

⁴ In accordance with Section 8629 of the Government Code.

The bill should be amended to provide an operative date that is tied directly to expenditures paid or incurred during a calendar quarter or prior to a calendar date.

It is unclear if the \$2,500 cap would apply to the amount of credit per taxable year to a qualified taxpayer or costs eligible for a credit per taxable year. The absence of clarity could lead to disputes with taxpayers and would complicate the administration of this credit.

Because the bill fails to specify otherwise, the \$2,500 annual cap on the credit would apply to each owner of a qualified property. For example, a qualified property owned by two qualified taxpayers could generate a credit of up to \$5,000. If this is contrary to the author's intent, the bill should be amended to specify that the \$2,500 per year is per property.

This bill uses terms that are undefined, i.e., "residential hotels," and "outdoor landscapes." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

The definition of "water-efficiency improvement" could be broadly interpreted. For example, the language of the bill states that a credit shall be allowed to meet a "locally adopted regulation or restriction." If a city requires that its residents only water one day a week and a resident installs a timer to meet that ordinance, is that a qualified improvement? It is recommended that the bill be amended to clearly express the author's intent.

TECHNICAL CONSIDERATIONS

On page 2, line 32, after "not" the word "to" is missing.

The term "single-family real property" that appears in paragraph (2) of subdivision (b) needs to be amended, as it should be "single-family residential real property" to correspond to the definition in paragraph (4) of subdivision (b).

LEGISLATIVE HISTORY

AB 603 (Salas, 2015/2016) would, under both the PITL and CTL, for taxable years beginning on and after January 1, 2015, allow a credit to a taxpayer participating in a lawn replacement program in an amount equal to \$2 per square foot of conventional lawn removed from the taxpayer's property. AB 603 is pending before the Assembly Revenue and Taxation Committee.

AB 2434 (Gomez, Chapter 738, Statutes of 2014) excludes from gross income, under both the PITL and CTL, amounts received as a rebate, voucher, or other financial incentive issued by a local water agency for participation in a turf removal water conservation program. The exclusion will be in effect for taxable years 2014 through 2018.

AB 2537 (Grove, 2013/2014), would have allowed a tax credit equal to 25 percent of a taxpayer's qualified costs to install one or more water-conserving plumbing fixtures, not to exceed \$2,500 per taxable year. This bill failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

OTHER STATES' INFORMATION

A review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no credits comparable to the credit this bill would allow. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 585 As Amended March 16, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$86	- \$95	- \$110

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

Revenue Discussion

Based on data from the U.S. Census, California water districts, and the NASA Ames Research Center, it is estimated that 420,000 qualified taxpayers would make outdoor landscape water efficiency improvements in 2015. This number has been adjusted to account for properties with multiple owners. To qualify for the credit, a qualified taxpayer must make improvements in accordance with local water-efficient landscape ordinances, regulations or established outdoor landscape efficiency programs. It is estimated that taxpayers would spend from \$400 to \$10,000 on drought related improvements; the resulting in an estimated weighted average credit amount of \$300, for an estimated total credit generated of \$128 million in 2015. It is assumed that 90 percent of the credit would be used in the year generated, and because the bill lacks a carryover provision, the remainder would not be used. This estimate assumes the full impact of this bill would be phased in over 4 years, with 30 percent of qualified taxpayers taking the credit in the first year, 75 percent in the second year, and 85 percent in the third year, resulting in credits used of \$34 million in 2015, \$88 million in 2016, and \$102 million in 2017. These amounts were converted to fiscal years and rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would assist in easing California's drought by encouraging taxpayers to make water-efficiency improvements to outdoor landscapes.

Opponents: Some may argue that water conservation is a critical state interest and should be more robustly encouraged by expanding the credit to the installations of all water conserving fixtures and appliances.

POLICY CONCERNS

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

This bill would provide a tax benefit for business entities subject to the PITL that would not be provided to business entities that are subject to CTL. Thus, this bill would provide differing treatment based solely on classification.

This bill would allow a credit for installing water-efficient landscapes that may be currently deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

This bill would allow taxpayers in certain circumstances, to claim multiple tax credit benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov