

ANALYSIS OF ORIGINAL BILL

Author: Salas Analyst: Jane Raboy Bill Number: AB 603
 See Legislative
 Related Bills: History Telephone: 845-5718 Introduced Date: February 24, 2015
 Attorney: Bruce Langston Sponsor _____

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| SUBJECT: | Lawn Replacement Credit |
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SUMMARY

This bill, under the Personal Income Tax (PITL) and Corporation Tax Laws (CTL), would allow a credit for participating in a lawn replacement program.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to encourage consumers to decrease water usage by providing a tax credit for the removal and replacement of conventional grass landscapes.

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.

FEDERAL/STATE LAW

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 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.

The CTL allows the assignment of certain eligible credits to taxpayers that are members of a combined reporting group. "Assignment" refers to the ability of a taxpayer that is a member of a combined reporting group to elect to transfer certain unused credits to a related corporation, as specified. The election to transfer 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.

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THIS BILL

This bill would allow a qualified taxpayer a tax credit of \$2 per square foot of conventional lawn removed from the qualified taxpayer's property.

This bill would define the following phrases:

- "Lawn replacement program" means a local water agency program that offers incentives to customers encouraging the replacement of conventional lawns with artificial lawns, drought-resistant plants, or other water-efficient landscaping.
- "Qualified taxpayer" means a person participating in a lawn replacement program offered by a local water agency.

This bill would not be subject to Section 41.¹

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.

The bill lacks administrative details that must be developed in order to implement the bill and determine its impacts to the department's systems, forms, and processes. This bill is silent on the following issues:

- How would the department verify that a taxpayer "participated in a lawn replacement program"?
- If a taxpayer removes the conventional lawn without replacing the lawn with artificial lawn or drought-resistant plants would they qualify for a tax credit?

This bill uses a term that is undefined, i.e., "conventional lawn." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill would allow a credit for a person participating in a lawn replacement program without requiring verification of expenses incurred to participate in a lawn replacement program. If this is contrary to the author's intent, the author may wish to amend the bill.

¹ Revenue and Taxation Code section 41 requires that tax credits contain specified goals, purposes, and objectives that the tax credit will achieve and detailed performance indicators, including data collection requirements as specified, to measure whether the credit is meeting those goals, purposes, and objectives.

LEGISLATIVE HISTORY

AB 2434 (Gomez, Chapter 38, Statutes of 2014), under the PITL and CTL, excludes from gross income amounts received for participation in a turf removal water conservation program. The exclusion is available for taxable years beginning on or after January 1, 2014, and before January 1, 2019.

AB 2537 (Grove, 2013/2014), would have allowed a credit equal to 25 percent of the amount paid or incurred during the taxable year for the installation of one or more "water-conserving plumbing fixtures" by a licensed plumber to replace a "noncompliant plumbing fixture" on "qualified real property" in California. This bill was held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a credit 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

Costs to implement this bill have yet to be determined. As the bill continues to move through the legislative process and the implementation concerns are resolved, 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 603 As Introduced February 24, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions) | | |
|--|---------|---------|
| 2015-16 | 2016-17 | 2017-18 |
| - \$49 | - \$60 | - \$85 |

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 the number of households that would replace lawns with drought alternative landscaping is 7,500 in 2015. To qualify for the credit, a taxpayer must be participating in a lawn replacement program offered by a local water agency; however, there is no certification requirement to claim the credit. It is further assumed the local water agencies' lawn replacement programs would accommodate taxpayers who want to replace their lawns. Based

on data from the Public Policy Institute of California, the average irrigated yard size is 3,000 square feet. Applying the credit amount of \$2 per square foot, results in a credit generated of \$45 million in 2015 (7,500 x 3,000 x \$2). It is assumed that 90 percent would be used in the year generated and the remainder would go unused. This estimate assumes the full impact of this bill for individuals would be fully phased in over 5 years, with 30 percent of the eligible taxpayers taking the credit in the first year, 45 percent in the second year, and 60 percent in the third year, resulting in credits used of \$12 million in 2015, \$19 million in 2016, and \$25 million in 2017.

Based on the same data, it is estimated that commercial building owners would replace 70 million square feet of lawn with drought alternative landscaping in 2015. After applying a credit of \$2 per square foot, the estimated total credit generated is \$140 million (70 million x \$2). It is assumed that 80 percent of the credit would be used in the year generated and the remainder would go unused. This estimate assumes the full impact of this bill for commercial properties would be fully phased in over seven years, with 15 percent in year one, 25 percent in year two, and 40 percent in year three, resulting in credits used of \$17 million in 2015, \$28 million in 2016 and \$45 million in 2017.

The tax year estimates are converted to fiscal year estimates and rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would encourage consumers to decrease water usage through the purchase of drought-resistant plants or artificial lawns.

Opponents: Some may argue that this credit may reward activity that would have been undertaken absent the credit.

POLICY CONCERNS

Generally, tax credits are enacted to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. Because there are currently local water agencies that offer a credit or rebate for lawn replacement, this bill would provide a tax credit for an action that has already taken place before this bill's enactment.

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 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 allow a credit for lawn replacement expenses that are currently deductible as business expenses to taxpayers engaged in a trade or business. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

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