

# SUMMARY ANALYSIS OF AMENDED BILL

Author: Salas, et al. Analyst: Jane Raboy Bill Number: AB 603  
 Related Bills: See Prior Analysis Telephone: 845-5718 Amended Date: May 21, 2015  
 Attorney: Bruce Langston Sponsor \_\_\_\_\_

<b>SUBJECT:</b>	Every Drop Counts Tax Credit
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## SUMMARY

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

## RECOMMENDATION

No position.

## SUMMARY OF AMENDMENTS

The May 21, 2015, amendments revised the tax credit requirements, defined new terms, and added a carryover period, recapture language, and a sunset provision. These amendments resolved all policy concerns and implementation concerns as discussed in the department's analysis of the bill as introduced on February 24, 2015.

Except for the "Effective/Operative Date," "This Bill," "Implementation Concerns," "Economic Impact," and "Policy Concerns" sections, the remainder of the department's analysis of the bill as introduced on February 24, 2015, still applies. The revised "Support/Opposition" and "Fiscal Impact" sections have been provided below for convenience.

## 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, 2016, and before January 1, 2021.

## THIS BILL

This bill would allow a qualified taxpayer a tax credit equal to 25 percent of the qualified costs paid or incurred by the qualified taxpayer to replace conventional lawn on the qualified taxpayer's property during the taxable year. The amount of credit allowed for a taxable year could not exceed \$1,500 in a taxable year.

This bill would specify if the new enacted law is repealed, the credit would be allowed only for the taxable year that began on or before the date upon which the state of emergency is terminated.

This bill would define the following phrases:

- "Conventional lawn" means living, maintained grass turf, or as otherwise defined by the lawn replacement rebate program.

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- "Lawn replacement rebate program" means a program that offers incentives to customers encouraging the replacement of conventional lawns with artificial lawns, drought-resistant plants, or other water-efficient landscaping.
- "Local water agency" means a public entity, as that term is defined in Section 514 of the Water Code that includes a city, county, city and county, whether general law or chartered, a district, board, commission, bureau, authority, agency, department, division, section, any other political subdivision of the state of any kind, or the state, that provides water service, as that term is defined in Section 515 of the Water Code to mean the sale, lease, rental, furnishing, or delivery of water for beneficial use, and includes, but is not limited to, contracting for that sale, lease, rental, furnishing, or delivery of water, except bottled water, and offers a lawn replacement rebate program.
- "Qualified costs" means the amount identified as costs eligible for a rebate pursuant to a lawn replacement rebate program in excess of the amount of the rebate actually received from the local water agency.
- "Qualified taxpayer" means a person participating in a lawn replacement program offered by a local water agency.
- "State of emergency" means the state of emergency proclaimed by the Governor on January 17, 2014, relating to drought conditions.

This bill would provide the following requirements:

- A credit would not be allowed for the removal of conventional lawn from a property for which a qualified taxpayer has been allowed the credit for a prior taxable year.
- A credit would be allowed only for that amount that exceeds the amount of rebate paid to the qualified taxpayer by a local water agency for the replacement of conventional lawn with artificial lawn, drought-resistant plants, or other water-efficient landscaping.

Unused tax credits could be carried forward up to five years, if necessary, until the credit is exhausted.

The amount of the credit allowed would be reduced by any deduction for any amount paid or incurred by a taxpayer upon which the credit is based.

In the event that a rebate is received in a year subsequent to the taxable year for which the credit was allowed, this bill would require the following:

- Recapture of the excess credit amount in the taxable year that the rebate was received. The excess credit amount would equal the difference between the amount of credit allowed and the amount of credit that would have been allowed if the rebate had been received in the taxable year.
- Add the excess credit amount to the tax otherwise owed by the qualified taxpayer for the taxpayer year in which the rebate was received.

- Treat the recapture, in whole or in part, as a math error appearing on the return and that any amount resulting from the recapture would be assessed by the Franchise Tax Board, in the same manner as provided by Section 19051.<sup>1</sup>

This bill would not be subject to Section 41.<sup>2</sup>

This bill's provisions would remain in effect only until December 1, 2021, and as of that date is repealed. If the state of emergency is terminated by proclamation of the Governor or by concurrent resolution of the Legislature declaring it at an end,<sup>3</sup> prior to December 1, 2021, this bill would remain in effect only until December 1 of the year following the year in which the state of emergency is terminated, and as of that date is repealed.

## IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

## FISCAL IMPACT

Costs to implement this bill have yet to be determined. As the bill continues to move 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 603 As Amended May 21, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$23	- \$26	- \$30

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

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<sup>1</sup> A math error appearing on the return results in an assessment that is due and payable on notice and demand instead of by a notice of proposed assessment with prepayment protest rights that generally is issued after an audit.

<sup>2</sup> 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.

<sup>3</sup> See Government Code section 8629.

### **Revenue Discussion:**

Based on data from the U.S. Census, California water districts, and the NASA Ames Research Center, it is estimated the number of households that would replace lawns with drought alternative landscaping is 6,400 in 2016. This number was tripled to approximately 19,000 to account for heightened public awareness due to the ongoing drought, the Governor's mandated 25 percent water reduction, and an increase in the number of water districts that offer turf rebate programs. To qualify for the credit, a taxpayer must be participating in a lawn replacement rebate program offered by a local water agency. It is assumed the local water agencies' lawn replacement rebate programs funding would accommodate taxpayers who want to replace their lawns. It is further assumed most taxpayers would qualify for the maximum credit of \$1,500 resulting in a credit of \$26 million in 2016. This estimate assumes the full impact for personal income tax filers would be phased in over 2 years with 40 percent in the first year and 85 percent in the second year. It is further assumed that 90 percent of the credit would be used in the first year and 10 percent would be used in the second year resulting in a credit claimed of \$9.4 million in 2016. As specified in the bill, turf removal and replacement expenses that would otherwise be deducted on the tax return must be reduced by the amount of credit taken, resulting in a \$393,000 expense add back in 2016 for rental property, since this does not apply to owner occupied houses. After applying a marginal tax rate of 6 percent the tax impact of the add back is \$24,000.

Based on the same data it is estimated 2,000 commercial building owners would replace grass with drought alternative landscaping in 2016. It is assumed building owners would qualify for the maximum credit of \$1,500, resulting in a credit of \$3.2 million. This estimate assumes the full impact of this bill for commercial properties would be fully phased in over three years with 40 percent in year one, 65 percent in year two and 90 percent in year three. It is further assumed that 90 percent of the credit would be used in the first year and 10 percent would be used in the second year, resulting in credits of \$910,000 in 2016. It is estimated \$912,000 of turf removal and replacement expenses would be added back. After applying a marginal tax rate of 5 percent the tax impact of the add back is \$50,000 in 2016.

The cumulative net impact of both the credit and the expense add back is \$10 million in 2016, \$23 million and \$29 million in 2017 and 2018 respectively.

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

## **SUPPORT/OPPOSITION<sup>4</sup>**

Support: Association of California Water Agencies, California Apartment Association, California Building Industry Association, California Landscape Contractors Association, California Municipal Utilities Association, City of Pasadena, Desert Water Agency, Metropolitan Water District of Southern California, and San Diego County Water Authority.

Opposition: California Tax Reform Association.

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<sup>4</sup> As noted in the Assembly Committee on Revenue and Taxation bill analysis dated May 18, 2015.