

ANALYSIS OF AMENDED BILL

Author: Campos Analyst: Jane Raboy Bill Number: AB 1139
 See Legislative
 Related Bills: History Telephone: 845-5718 Amended Date: March 26, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Lawn Replacement Credit
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SUMMARY

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

RECOMMENDATION

No position.

Summary of Amendments

The March 26, 2015, amendments eliminated nonsubstantive changes to the Revenue and Taxation Code and replaced them with the provisions discussed in this analysis.

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

REASON FOR THE BILL

The reason for this bill is to encourage consumers to conserve water usage by providing a tax credit for participation in a lawn replacement program.

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.

For state purposes, any amount received as a rebate, voucher, or other financial incentive issued by a local water agency or supplier for participation in a turf removal water conservation program is excluded from gross income.

There are currently no federal or state credits comparable to the credit this bill would create.

Board Position:	Executive Officer	Date
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THIS BILL

For each taxable year beginning on or after January 1, 2015, this bill would allow a qualified taxpayer subject to the PITL, a tax credit in an amount equal to \$2 per square foot of conventional lawn removed from the qualified taxpayer's qualified real property, not to exceed \$50,000 per taxable year.

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.
- "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 in this state.
- "Qualified taxpayer" means a person¹ (includes individuals, fiduciaries, partnerships, limited liability companies and corporations) participating in a lawn replacement program offered by a local water agency.
- "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.

This bill would not be subject to the requirements of Revenue and Taxation Code section 41.²

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 uses phrases that are undefined, i.e., "participated in a lawn replacement program," "local water agency," "residential hotels", and "not residential hotels". The absence of definitions to clarify these phrases could lead to disputes with taxpayers and would complicate the administration of this credit. It is recommended that the bill be amended to provide a definition for these phrases.

¹ See Revenue and Taxation (R&TC) Code section 17007 for definition of "person".

² 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.

The term "person" includes individuals, fiduciaries, partnerships, limited liability companies, and corporations. This may be overly broad, allowing multiple persons to claim this credit based on the same lawn removal. For example, a partnership that owns the property could claim the credit and each individual on a married filing joint return could be eligible for this credit. If this is contrary to the author's intent, this bill should be amended to replace "person" with "taxpayer".

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 person "participated in a lawn replacement program" or that the square footage of lawn was removed?
- If a condo or homeowner's association replaces the lawn, it is unclear how a condo owner would qualify for this credit? For example, if a condo owner owns their unit, and owns a percentage of all the common ground fees, would the credit be limited to the percentage of ownership?
- Would partners in a partnership and shareholders of an "S" corporation be allowed to claim their pass-through share of the credit? Alternatively, would each qualified taxpayer be allowed to claim \$50,000 per return?

For clarity and to avoid disputes between individuals and the department, the author may wish to consider amending this bill to include a certification process, including providing certifications to the Franchise Tax Board.

This bill is silent on whether the lawn replacement credit applies to costs that are either paid or incurred during the taxable year. To allow for both cash-basis and accrual-basis accounting methods, the author may wish to amend the bill's language.

TECHNICAL CONSIDERATIONS

The phrase "single-family real property," on page 3 line 2, should read "single-family residential real property" to correspond to the defined term.

LEGISLATIVE HISTORY

AB 585 (Melendez, 2015/2016) would allow a credit equal to 25 percent of the amount paid for water-efficiency improvements made to outdoor landscapes on qualified real property in California, not to exceed \$2,500 per taxable year. AB 585 is currently in the Assembly Revenue & Taxation Committee.

AB 603 (Salas, 2015/2016), similar to this bill, would allow a credit for participating in a lawn replacement program. AB 603 is currently in the Assembly Revenue & Taxation Committee.

AB 2434 (Gomez, Chapter 38, Statutes of 2014), under the PITL and Corporation Tax Law, 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 1139 As Amended March 26, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$31	- \$30	- \$40

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, the NASA Ames Research Center, and the impact of the Governor's recent mandatory water reduction order, it is estimated that the number of qualified properties that would replace lawns with drought alternative landscaping is 10,000 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 \$60 million in 2015. 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 would be fully phased over 5 years, with 30 percent of 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 \$16 million, \$25 million and \$34 million in years 2015 through 2017, respectively.

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

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

There is no limitation on the amount of times a taxpayer may claim this credit in a year (up to \$50,000) or a limitation on the amount of the credit applying to the same property that may be claimed multiple times over multiple tax years.

Generally, tax credits are enacted to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. This bill would allow a credit for lawn removal that occurred prior to the enactment of this bill.

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a credit that lacks an economic outlay requirement, which is unprecedented.

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.

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