

ANALYSIS OF ORIGINAL BILL

Author: Melendez Analyst: Diane Deatherage Bill Number: AB 2040
 See Legislative
 Related Bills: History Telephone: 845-4783 Introduced Date: February 17, 2016
 Attorney: Bruce Langston Sponsor _____

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| SUBJECT: | Outdoor Water-Efficiency Improvement Credit/Outdoor Water-Efficiency Act of 2016 |
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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.

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, 2017, and before January 1, 2022.

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 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 2018.¹

¹ R&TC sections [17138.2](#) and [24308.2](#).

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

THIS BILL

For each taxable year beginning on or after January 1, 2017, and before January 1, 2022, 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.

For each qualified real property, the credit could not cumulatively exceed \$2,500 for all taxable years.

The bill would define the following phrases:

- “Qualified real property” means a principal residence of the qualified taxpayer within the meaning of Section 121 of the Internal Revenue Code, relating to exclusion of gain from sale of principal residence, in this state.
- “Qualified taxpayer” means the owner of any qualified real property.
- “Water-efficiency improvements” means expenditures voluntarily paid or incurred by the qualified taxpayer that are certified by the appropriate regional or local water agency as water-efficient improvements compatible with any of the following:
 - A local water-efficient landscape ordinance of a regional or local water agency adopted or in effect at the time the improvements are made.
 - The state water-efficient landscape statutes adopted or in effect at the time the improvements are made.
 - 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.

“Water-efficiency improvements” do not include improvements performed to bring landscaping into mandatory compliance with a local water-efficient landscape ordinance or state law.

A qualified taxpayer would be required to:

- Obtain certification of the water-efficiency improvements from the appropriate regional or local water agency after completion of those improvements;
- Retain a copy of the certification received and, upon request, provide a copy of that certification to the Franchise Tax Board.

This credit would be in lieu of any other credit or deduction that the qualified taxpayer may otherwise claim with respect to the amounts paid or incurred for water-efficiency improvements for outdoor landscapes on qualified real property in this state.

The credit may be carried over for up to four years, or until exhausted.

Section 41² would not apply to the credit allowed by this bill.

This credit would remain in effect until December 1, 2022, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 585 (Melendez, 2015/2016) would have, under the PITL, allowed a tax credit to a taxpayer for water-efficient improvements to outdoor landscapes. AB 585 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

AB 603 (Salas, 2015/2016) would have, under both the PITL and CTL, allowed 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 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

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.

² The Revenue and Taxation Code section 41 requires any new tax credit legislation introduced on or after January 1, 2015, to include specific goals, purposes, objectives, and performance measures.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and a budget change proposal will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill will result in the following revenue loss:

| Estimated Revenue Impact of AB 2040 As Introduced February 17, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions) | | |
|---|---------|---------|
| 2016-17 | 2017-18 | 2018-19 |
| - \$25 | - \$50 | - \$65 |

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 250,000 households that are single-family owner-occupied homes would make outdoor landscape water-efficiency improvements in 2017. It is estimated that taxpayers will spend from \$400 to \$10,000 on drought-related improvements; the resulting estimated weighted average of the credit would be \$325 per qualifying property, for an estimated total credit generated of \$80 million in 2017. This estimate assumes the full impact of this bill would be phased in over four years, with 60 percent of eligible taxpayers claiming the credit in the first year, 75 percent in the second year, and 85 percent in the third year. It is further assumed that 90 percent of the credit would be used in the year generated, and the remainder would be used over the next three years. As a result, the estimated revenue loss is \$44 million in tax year 2017.

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

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.

LEGISLATIVE STAFF CONTACT

Diane Deatherage
Legislative Analyst, FTB
(916) 845-4783
diane.deatherage@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