Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Melendez	Analyst:	Diane Deatherage	Bill Number:	AB 2040
Related Bills:	See Prior Analysis	Telephone:	845-4783	Amended Date:	May 16, 2016
		Attorney:	Bruce Langston	Sponsor	

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

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 May 16, 2016, amendments modified the sunset and repeal dates, added an income limitation for determining eligibility for the credit, added language to adjust the amount of the credit by the tax credit adjustment factor, and made the bill's provisions contingent upon an appropriation in any budget measure.

These amendments created one implementation consideration, one technical consideration and one policy concern.

Except for the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," "Support/Opposition," and "Policy Concerns" sections, the remainder of the department's analysis of the bill as amended on April 6, 2016, still applies. The "Fiscal Impact" section is restated 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, 2019.

This bill would only become operative for taxable years for which resources are authorized in any budget measure for the Franchise Tax Board (FTB) to oversee and audit returns associated with the credit.

THIS BILL

For each taxable year beginning on or after January 1, 2016, and before January 1, 2019, 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, as modified by the tax credit adjustment factor for the taxable year.

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" would mean 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" would mean the owner of any qualified real property whose income does not exceed 120 percent of the area median income of the county in which he or she resides.
- "Water-efficiency improvements" would mean 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" would 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 FTB.

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 amount of the credit would be multiplied by the tax credit adjustment factor for the taxable year. Unless otherwise specified in any budget measure, the tax credit adjustment factor for a taxable year beginning on or after January 1, 2016, would be 0 percent.

The tax credit authorized would only be operative for taxable years for which resources are authorized in any budget measure for the FTB to oversee and audit returns associated with the credit.

The credit would be allowed to be carried over for up to four years, if necessary, until the credit is exhausted.

Revenue and Taxation Code (R&TC) section 41[1] would not apply to the credit allowed by this bill.

This credit would remain in effect until December 1, 2019, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

The credit would be allowed to a qualified taxpayer who is a qualified real property owner "whose income does not exceed 120 percent of the area median income of the county in which he or she resides," but it is unclear how the department would verify the qualified taxpayer's income meets the eligibility requirement. For clarity and ease of administration, it is recommended that the bill be amended to instead use the qualified taxpayer's adjusted gross income as an income limitation for determining eligibility for the credit.

TECHNICAL CONSIDERATIONS

For clarity and consistent use of terminology, the phrase "any budget measure" should be replaced with the commonly-used phrase "the annual Budget Act."

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.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2040 As Amended May 16, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19
- $27	- $22	- $27

[1] 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.

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 FTB, it is estimated that 87,000 households are single family owner occupied homes with income 120 percent or less of the California median income would make outdoor landscape water-efficiency improvements in 2016.

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 $28 million in 2016. 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 $15 million in tax year 2016.

The tax-year estimates are converted to fiscal-year estimates and then rounded to arrive at the amounts shown in the above table. This estimate assumes funds necessary for administration costs would be appropriated in the budget each year.

SUPPORT/OPPOSITION[2]

Support: A-G Sod Farms, Inc.; California Apartment Association; California Association of Nurseries and Garden Centers; California Municipal Utilities Association; California Retailers Association; City of Lakewood; Consumer Specialty Products Association; League of California Cities; Nursery Growers Association; Scotts Miracle-Gro Company; and West Coast Turf.

Opposition: California Tax Reform Association.

POLICY CONCERNS

Credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. However, linking the credit operative date to the budget measure enacted mid-year or later would reduce this bill's incentive and could impact taxpayer behavior.

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[2] Assembly Revenue and Taxation Committee analysis, dated May 5, 2016.

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