

## Franchise Tax Board

## ANALYSIS OF ORIGINAL BILL

Author: Calderon Analyst: Funmi Obatolu Bill Number: AB 1341  
Related Bills: See Legislative History Telephone: 845-5845 Introduced Date: February 17, 2017  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Near-Zero-Emission and Zero-Emission Vehicle Credit and Deduction FTB Report to Legislature Annually Regarding Efficacy of Credit & Deduction

### SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow a qualified taxpayer:

- A credit for the purchase of a new electric vehicle.
- A deduction for the purchase of a used near-zero or zero-emission vehicle.

This analysis only addresses the provisions of the bill that would impact the department's programs and operations.

### RECOMMENDATION – NO POSITION

### REASON FOR THE BILL

The reason for the bill is to promote near-zero-emission and zero-emission vehicle deployment in disadvantaged California communities, to drastically increase the use of those vehicles, and to meet specified goals established by the Governor and the Legislature.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2018, and specifically operative for taxable years beginning on or after January 1, 2018, and before January 1, 2026.

### PROGRAM BACKGROUND

The Center for Sustainable Energy administers the Clean Vehicle Rebate Program (Rebate Program)<sup>1</sup> throughout the state for the California Air Resources Board.

The Rebate Program promotes clean vehicle adoption by offering rebates of up to \$6,500 for the purchase or lease of new, eligible zero-emission vehicles, including electric, plug-in hybrid electric, and fuel cell vehicles.

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<sup>1</sup>This program was created in 2014 with the enactment of the Charge Ahead California Initiative (Health and Safety Code sections 44258 - 44258.5).

The California Air Resources Board recently approved a funding plan that included an income cap for higher-income consumers and increased rebate levels for low and moderate-income consumers participating in the Rebate Program, effective for rebate applications for vehicles purchased or leased on or after March 29, 2016.

## **FEDERAL/STATE LAW**

### ***Above-the-line deductions***

Existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating adjusted gross income (AGI), such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self-employed individuals, retirement savings, and alimony. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as above-the-line deductions.

### ***Credits***

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.

## **THIS BILL**

### ***New Electric Vehicle Credit***

Under the PITL, for each taxable year beginning on or after January 1, 2018, and before January 1, 2026, a qualified taxpayer would be allowed a tax credit in an amount equal to the following amounts for new vehicles:

- \$1,500 for plug-in hybrid electric vehicles with an electric range of more than 20 miles.
- \$2,500 for battery electric vehicles.
- \$5,000 for hydrogen fuel cell electric vehicles.

The bill would allow any unused credit to be carried forward for seven years.

The bill contains language that it is the intent of the Legislature to enact legislation to provide that the credit would be refundable, upon appropriation, if the amount of the credit exceeds the taxpayer's net tax, in lieu of the credit carry forward.

For purposes of the credit, this bill would define the following:

"Qualified taxpayer" means an individual or individuals who meet the income eligibility requirements specified by the State Air Resources Board<sup>2</sup> and who purchased a near-zero-emission or zero-emission vehicle during the taxable year.

"Near-zero-emission vehicle" means a vehicle that utilizes zero-emission technologies, enables technologies that provide a pathway to zero-emissions operations, or incorporates other technologies that significantly reduce criteria pollutants, toxic air contaminants, and greenhouse gas emissions, as defined by the State Air Resources Board in consultation with the State Energy Resources Conservation and Development Commission consistent with meeting the state's mid- and long-term air quality standards and climate goals.

"Zero-emission vehicle" means a vehicle that produces no emissions of criteria pollutants, toxic air contaminants, and greenhouse gases when stationary or operating, as determined by the State Air Resources Board.

In lieu of the credit, a qualifying taxpayer purchasing a near-zero-emission or a zero-emission vehicle may assign the tax credit to a financing entity at the time of purchase by entering the following information into an election statement:

1. The vehicle identification number of the vehicle eligible for the credit.
2. An affirmation that all the following requirements have been met:
  - The vehicle purchased is a "Near-zero-emission or "Zero-emission" vehicle, as defined.
  - The individual or individuals purchasing the vehicle is a qualified taxpayer, as defined. The qualified taxpayer assigns the tax credit to the financing entity and forfeits the right to claim the tax credit on their tax return in exchange for good and valuable consideration.

The financing entity compensated the qualified taxpayer for the full nominal value of the tax credit. Such compensation would be considered a refund of state taxes and not considered as income to the qualified taxpayer. The financing entity would be required to electronically submit a report containing the information in the election statement to the Franchise Tax Board (FTB) within 30 days of the purchase of a near-zero or zero-emission vehicle. The FTB would be required to make the reported information available to the State Air Resources Board.

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<sup>2</sup> Eligibility requirements pursuant to Health and Safety Code section 44258.4(c)(3)(B).

### *Deduction For Purchase Of Used Near-Zero-Emission Or Zero-Emission Vehicle*

Under the PITL, for taxable years beginning on or after January 1, 2018, and before January 1, 2026, a qualified taxpayer, who during the taxable year, purchased a used near-zero or zero-emission vehicle, would be allowed an "above-the-line" deduction<sup>3</sup> in the following amounts:

- 1) \$1,500 for plug-in hybrid electric vehicles with an electric range of more than 20 miles.
- 2) \$2,500 for battery electric vehicles.
- 3) \$5,000 for hydrogen fuel cell electric vehicles.

For purposes of the deduction, this bill would define the following:

"Qualified taxpayer" would mean an individual or individuals who meet the income eligibility requirements specified by the State Air Resources Board.<sup>4</sup>

"Near-zero-emission vehicle" would mean a vehicle that utilizes zero-emission technologies, enables technologies that provide a pathway to zero-emissions operations, or incorporates other technologies that significantly reduce criteria pollutants, toxic air contaminants, and greenhouse gas emissions, as defined by the State Air Resources Board in consultation with the State Energy Resources Conservation and Development Commission consistent with meeting the state's mid- and long-term air quality standards and climate goals.

"Zero-emission vehicle" would mean a vehicle that produces no emissions of criteria pollutants, toxic air contaminants, and greenhouse gases when stationary or operating, as determined by the State Air Resources Board.

The FTB, in consultation with the State Board of Equalization, would be required to report regarding the efficacy of the bill's tax benefits to the Legislature by January 1, 2019, and annually each January 1, thereafter until January 1, 2027.

The tax credit and deduction provisions would remain in effect until December 1, 2026, and as of that date would be repealed.

### **IMPLEMENTATION CONSIDERATIONS**

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional considerations may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other considerations that may be identified.

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<sup>3</sup> A deduction that reduces gross income to arrive at adjusted gross income, before the itemized or standard deduction.

<sup>4</sup> Eligibility requirements pursuant to Health and Safety Code section 44258.4(c)(3)(B).

The bill would allow the credit or deduction irrespective of the vehicle's purchase price. For example, a qualified taxpayer who purchased a used battery electric vehicle for less than \$2,500 would receive a deduction of \$2,500. If this is contrary to the author's intent, the bill should be amended.

This bill uses terms and phrases that are undefined, i.e., "plug-in hybrid vehicles," "battery electric vehicles," "hydrogen fuel cell electric vehicles," "financing entity," "election statement," "good and valuable consideration." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

The definitions of "qualified taxpayer" lack language that would limit the credit or deduction to low- and moderate-income taxpayers. If this is contrary to the author's intent, the bill should be amended.

The department lacks expertise in electric, near-zero-emission, and zero-emission vehicle technology. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

This bill lacks administrative details necessary to implement the bill and determine its impacts to the department's systems, forms, and processes. The bill is silent or unclear on the following issues:

- It is unclear whether lease transactions would be eligible for the tax benefits this bill would allow.
- Because the bill fails to specify otherwise, no credit would be allowed on the purchase of a new near-zero or zero-emission vehicle if the vehicle utilized technology other than the specified electric technologies (plug-in hybrid electric, as specified, battery electric, or hydrogen fuel cell electric).
- What vehicles would meet the definition of near-zero emission? Zero-emission?
- Who would be responsible for developing the election statement? What specific information would be required on the election statement? When would the election statement be available?
- The bill is silent on a mechanism to allow a "financing entity" to utilize assigned tax credits. Further, it is unclear that any entity other than an individual that is a financing entity would be eligible to use assigned tax credits.
- The compensation paid a qualified taxpayer in exchange for the assignment of the credit would be treated as a refund of state taxes that could be subject to federal tax.
- Because the bill fails to specify otherwise, a vehicle purchased and used outside the state could be eligible for the tax benefits this bill would establish.
- Because the bill fails to specify otherwise, a used electric vehicle, as specified could generate an unlimited number of deductions. Additionally, the bill fails to limit the number of purchases a qualified taxpayer could make that would be eligible for the credit or deduction.

- Because the bill fails to specify otherwise a qualified taxpayer could, for example, purchase a new electric vehicle, as specified, thus generating a credit, and then sell that car (now a used electric vehicle, as specified) to another qualified taxpayer thus generating a deduction on the same vehicle in the same taxable year.

### LEGISLATIVE HISTORY

AB 1710 (Calderon 2015/2016) would have allowed a tax credit or a deduction for purchasing a near-zero-emission or zero-emission vehicle. AB 1710 failed to pass out of the Assembly by the constitutional deadline.

AB 998 (Kelley, 2001/2002) would have allowed a credit of 30 percent of the purchase price of a new zero-emission Neighborhood Electric Vehicle. AB 998 failed to pass out of the Assembly by the constitutional deadline.

SB 1726 (Burton, 1999/2000) would have allowed a credit of up to \$3,000 for each zero-emission vehicle leased or purchased. SB 1726 failed to pass out of the Senate Revenue and Taxation Committee.

### OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

None of these states provide a credit or deduction comparable to those proposed by this bill.

### FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves 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 1341* As Introduced February 17, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$60	- \$130	- \$160

\* The estimated impact of the deduction is less than 2 percent of the estimate shown in the table above.

This estimate assumes the implementation concerns, discussed above, have been resolved.

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 available electric vehicles and used car sales data, it is estimated that approximately 90,000 qualified new vehicles and 20,000 qualified used vehicles would be purchased by qualified taxpayers in 2018. It is estimated that 85 percent, or 94,000, would be purchased by qualified taxpayers who have taxable income.

For those who purchase a qualified new vehicle and claim the credit, the estimated generated would be \$175 million in taxable year 2018. It is assumed that 60 percent of the credit will be claimed in the year generated and the remaining 40 percent would be used over the next 7 years. This results in an estimated loss of \$105 million in 2018. It is estimated that for those who purchase a qualified used vehicle and claim the deduction, taxable income would be reduced by \$40 million in 2018. Using an average tax rate of 4 percent, the estimated loss from the deductions would be \$1.6 million in 2018.

The combined estimated revenue loss is \$107 million. The estimate is then adjusted to reflect changes in the economy over time. The tax-year estimates are 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 assist in reducing pollution in California by encouraging taxpayers to purchase near-zero-emission or zero-emission vehicles.

Opponents: Some may argue that air pollution is a critical state interest and should be more robustly encouraged by expanding eligibility for the tax benefits this bill would create.

### **POLICY CONCERNS**

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

The bill lacks a requirement for the vehicle to be registered or operated in California.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

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