



Summary Analysis of Amended Bill

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Sponsor:

Bill Number: AB 2042

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Amended: May 1, 2018

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Related Bills: See Prior Analysis

Subject: Residential Graywater Reuse System Credit

Summary

This bill would, under the Personal Income Tax Law (PITL), allow a tax credit to taxpayers that install residential graywater reuse systems.

Recommendation – No position.

Summary of Amendments

The May 1, 2018, amendments modified eligibility for the credit and eliminated the provision allowing the credit in lieu of any otherwise allowable depreciation. As a result of the amendments, three of the implementation considerations and the legal impact discussed in the department's analysis of the bill as amended March 19, 2018, have been resolved and additional implementation considerations have been identified.

Except for the "This Bill," "Implementation Considerations," "Economic Impact," and "Legal Impact" sections, the remainder of the department's analysis of the bill as amended March 19, 2018, still applies. The "Fiscal Impact" section has been restated below for convenience.

This Bill

For each taxable year beginning on or after January 1, 2019, and ending before January 1, 2024, this bill would, under the PITL, allow a taxpayer a tax credit for the cost of installing a residential graywater reuse system during the taxable year in the taxpayer's residence located in this state.

This bill includes the following credit limitations:

- The credit would be limited to 25 percent of the cost of the residential graywater reuse system, up to \$1,000 credit per residence as evidenced by the receipt issued by the Franchise Tax Board (FTB).
- The person that provides the residential graywater reuse system would be required to furnish to the taxpayer an accounting of the system's cost.
- The credit could be claimed once per taxable year.

- Credit in excess of the “net tax,” as defined by Section 17039, could be carried over for up to six years, until exhausted.
- For married individuals filing separate returns, the credit would be limited to one-half the amount that could be claimed on a joint return.
- The residential graywater reuse system and its installation would be required to comply with Department of Housing and Community Development rules.
- A graywater stub out installed by the home or dwelling unit builder prior to the taxpayer obtaining title to the underlying property would be ineligible for this credit.

On and after January 1, 2019, the FTB would be required to:

- Receive and evaluate applications for the residential graywater reuse system credit submitted by taxpayers.
- Prescribe the form of the application which must include:
 - The applicant’s name, address, and social security number or federal employer identification number of the applicant;
 - The amount of the cost of the residential graywater reuse system;
 - The amount for which the credit is claimed; and
 - Any additional information that the FTB requires.
- Review each application received and certify to the taxpayer the credit amount authorized and that the credit amount is less than the annual certification limit of \$250,000 per calendar year.
- Authorize credits in the order of the date the application is received if the qualifying applications exceed the \$250,000 calendar year limit.
- Limit a credit that would, if authorized, exceed the limit, to the amount remaining to reach the \$250,000 calendar year limit.
- Deny subsequent applications received in that calendar year that, if authorized, would exceed the \$250,000 limit.

The FTB would be prohibited from authorizing tax credits in excess of the \$250,000 limit in the event that amounts previously certified for the calendar year are unclaimed or a taxpayer fails to meet the requirements to claim the additional credit.

The FTB would be allowed to verify that a residential graywater reuse system has been installed in the taxpayer’s residence.

This bill would define the term “residential graywater reuse system” as meaning a system or a series of components or mechanisms that are designed to provide for the collection of residential graywater and includes a system that is capable of storing residential graywater for future use and reusing the collected water for the same residential property.

This bill includes off code language stating the specific goals, purposes, objectives, and performance measures, as required by Revenue and Taxation Code section 41.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns 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 concerns that may be identified.

This bill uses terms that are undefined, i.e., "only once in a taxable year," "residence," and "receipt;" and appears to use the phrases "costs of installing a residential graywater reuse system" and "cost of the residential graywater reuse system" as synonyms. The absence of definitions to clarify the undefined terms and inconsistent use of terminology could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define and consistently use terminology.

It is unclear whether the \$1,000 limit applies to the maximum credit allowed, the maximum cost used to determine the credit, or the maximum amount of the certificate or certificates issued to a taxpayer by the FTB.

A taxpayer with more than one residence during a taxable year (i.e., moved during the taxable year) that is otherwise eligible for this credit would be limited to a credit on the first residence. If this is contrary to the author's intent, this bill should be amended.

A taxpayer whose application is denied because the aggregate credit for a calendar year had been met would be ineligible to resubmit the application using costs incurred in a prior taxable year. If this is contrary to the author's intent, the author may wish to amend this bill to allow the credit for the taxable year that certification is received.

Because the bill fails to specify otherwise, the credit could be reported on either an originally filed return or an amended return, thus allowing taxpayers to file an amended return, as allowed by statute, to modify the claimed credit. As a result, the aggregate use of the credit could fall below the annual allocation limit.

Because this bill is silent on the applicability of the underpayment penalties, a taxpayer denied the credit because the aggregate credit limit had been reached would be subject to these penalties. If this is contrary to the author's intent, this bill should be amended.

This bill would require the FTB to receive, evaluate, and certify applications for the credit allowed under its terms. The department lacks expertise with regard to residential graywater reuse systems and installation rules adopted by the Department of Housing and Community Development. 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.

For speed and ease of administration and taxpayer certainty, the author may wish to consider amending this bill to:

- Limit the credit to amounts claimed on a timely original return;
- Exclude the FTB's determinations from any administrative or judicial review process. For example, the determination of "first-to-file;"
- Specify that a disallowance of the credit shall be treated as a math error;
- Specify that the FTB may prescribe rules, guidelines, or procedures for the application and credit; and
- Exclude the rules, guidelines, or procedures regulations from the Administrative Procedures Act.

Fiscal Impact

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. 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 2042 as Amended May 1, 2018
Assumed Enactment after June 30, 2018

Fiscal Year	Revenue
2018-2019	- \$100,000
2019-2020	- \$200,000
2020-2021	- \$250,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Based on data from non-profit organizations and university studies, the average estimated cost to install a residential graywater reuse system for a single-unit residence would be \$6,000 and \$200,000 for a multi-unit residence. Because the credit is limited to 25 percent of the cost of installation or \$1,000 per system installed, it is assumed that each taxpayer would generate the maximum credit amount of \$1,000. Because the allocation is limited to \$250,000 per year, the maximum number of taxpayers able to claim the credit would be 250. It is assumed that

75 percent of taxpayers installing graywater reuse systems would learn of the credit in 2019. It is further assumed that taxpayers would be able use the full credit amount in the year generated, resulting in an estimated credit used of \$188,000 in 2019.

The tax-year estimates are converted to fiscal-year estimates as reflected in the amounts in the above table.

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