



Analysis of Original Bill

Author: Holden, et al.

Sponsor:

Bill Number: AB 533

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Introduced: February 13, 2019

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Related Bills: See Legislative
History

Subject: Exclusion from Gross Income Water Improvement Financial Incentives

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), exclude from gross income incentives received for water conservation, efficiency, or runoff management improvement programs.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to encourage participation in water conservation programs that increase water efficiency and improve storm water management by ensuring that financial incentives from consumer rebate programs are excluded from gross income in California.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment, and operative for taxable years beginning on or after January 1, 2019.

Federal/State Law

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Existing federal and state laws allow taxpayers to exclude from gross income any subsidy provided (directly or indirectly) by a public utility to customers for the purchase or installation of any energy conservation measure. An “energy conservation measure” is any installation or modification primarily designed to reduce consumption of electricity or natural gas or improve the management of energy demand in a dwelling unit as defined by federal law.

In general, in order to be excluded from gross income and treated as a refund or price adjustment of amounts payable, a rebate must be based on or related to the cost of the property purchased; the rebate must be received from someone having a reasonable connection to the sale of the property such as the manufacturer, distributor, or seller and installer; and the rebate must not represent payment or compensation for services.

This Bill

This bill would, under the PITL and the CTL, exclude from gross income any amount received as a rebate, voucher, or other financial incentive issued by a local water agency or supplier for:

- Any water conservation or efficiency program the primary purpose of which is to reduce consumption of water or to improve the management of water demand;
- Any water runoff management improvement program the primary purpose of which is to reduce the amount or manage the quality of storm water runoff.

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 terms that are undefined, i.e., "local water agency," and "supplier." The absence of definitions to clarify these terms 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 the terms.

Legislative History

AB 2283 (Holden, 2017/2018), would have extended the exclusion from gross income allowed under AB 2434 from taxable years beginning before January 1, 2019, to taxable years beginning before January 1, 2024. AB 2283 was held in the Assembly Appropriations Committee.

AB 2434 (Gomez, Chapter 738, Statutes of 2014) allowed for taxable years beginning on or after January 1, 2014, and before January 1, 2019, an exclusion from gross income for amounts 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.

Other States' Information

The states surveyed include *Arizona, Florida, 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.

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a comparable exclusion from gross income that this bill would allow.

Arizona allows a credit against personal income tax for expenses incurred to purchase and install an agricultural water conservation system in Arizona. The credit amount is limited to 75 percent of the expenses, and is allowed in lieu of any deduction otherwise allowed.

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 533 as Introduced February 13, 2019.
Assumed Enactment after June 30, 2019.

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$5.2
2020-2021	-\$3.5
2021-2022	-\$3.6

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

National census data indicates that there are approximately 14 million housing units in California. It is assumed that 12 percent, or 1.7 million homeowners, would incur qualified water conservation or water runoff management improvement expenses. Of those, it is assumed that 80 percent, or 1.3 million homeowners, would have access to programs offering rebates, vouchers, or other financial incentives.

Based on data from various public utilities located in California, it is estimated that the average residential rebate issued for participation in these programs is approximately \$400. Because taxpayers may implement more than one qualified improvement program during the year and thus receive multiple qualified rebates, the amount of potential rebates received is increased by 45 percent, to \$780 million. Because not all taxpayers understand that rebates, vouchers, or other financial incentives may be taxable, it is assumed that seven percent of residential homeowners would include the rebates in taxable income and thus benefit from the exclusion. A marginal tax rate of six percent is then applied, resulting in an estimated revenue loss of \$3.2 million in the 2019 taxable year.

Corporations generally follow financial reporting guidelines and treat financial incentives or rebates as refunds or price reductions, excluding them from taxable income, or decreasing the asset basis by the amount of financial incentive received. It is assumed that there would be no change in the way commercial property owners treat rebates.

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

Policy Concerns

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

Absent a comparable federal exclusion, the rebates would be subject to federal tax, and, similar to the recent turf replacement rebates, Forms 1099 could be issued to recipients of rebates in excess of \$600.¹ Thus, the incentive to participate in water conservation, efficiency, or runoff management improvement programs may be reduced.

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¹ [LA Times Article](http://www.latimes.com/local/lanow/la-me-ln-turf-rebate-taxes-20160121-story.html) (<http://www.latimes.com/local/lanow/la-me-ln-turf-rebate-taxes-20160121-story.html>)