STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Limon	Sponsor:	Bill Number: SB 1135
	Related Bills: See Legislative History	Introduced: February 13, 2024, Amended April 10, and April 25, 2024

SUBJECT

Greenhouse Gas Reduction Fund Tax Credit

SUMMARY

This bill, under the Personal Income Tax law (PITL) and Corporation Tax Law (CTL), would allow a business entity tax credit, subject to allocation by the Department of Food and Agriculture (DFA), for qualified expenses paid or incurred for application of compost on agricultural lands to improve soils, sequester carbon, and reduce greenhouse gas emissions.

RECOMMENDATION

No position—The Franchise Tax Board (FTB) has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

The April 10, 2024, amendments changed the credit allocating department to the DFA, specified that one time refund request be paid out of the California Compost Tax Credit Fund, and modified the amount of funds appropriated.

The April 25, 2024, amendments modified provisions of the bill administered by the DFA. These amendments would not impact the FTB.

This is the FTB's first analysis of the bill and only addresses the provisions that would impact the FTB.

REASON FOR THE BILL

The reason for the bill is to encourage the application of compost on agricultural lands, ranchlands, or rangelands.

ANALYSIS

This bill, under the PITL and the CTL, for taxable years beginning on or after January 1, 2025, and before January 1, 2036, would provide a tax credit to qualified taxpayers that paid or incurred qualified expenditures, subject to allocation by the DFA.

The FTB would be required to work with the DFA to develop the form for taxpayers to apply for credit allocation; taxpayers would be required to submit the form to DFA.

This bill would define the following terms:

"Qualified expenditure" means amounts paid or incurred by a qualified taxpayer during the taxable year for the application of compost on agricultural lands, ranchlands, or rangelands to improve soils, sequester carbon, and reduce greenhouse gas emissions. The application of the compost may include additional multibenefit purposes, such as increasing water retention and infiltration, preventing erosion, reducing soil dust, and improving water quality.

"Qualified taxpayer" would mean a business entity that has paid or incurred qualified expenditures and has been issued a credit allocation by the DFA. Additionally, in the case of any pass-thru entity, the determination of whether a taxpayer is a qualified taxpayer would be made at the entity level and any credit for this bill would be allowed to the pass-thru entity and passed through to the partners and shareholders in accordance with applicable provisions of the PITL and CTL. The term "pass-thru entity" means any partnership or "S" corporation.

Any deduction otherwise allowed to the qualified taxpayer for qualified expenditures would be reduced by the amount of the credit claimed.

This credit would be required to be taken in lieu of any other credit that the qualified taxpayer may otherwise claim with respect to qualified expenditures.

The unused credit would have an unlimited carryover period. Additionally, in lieu of carrying over unused credits, if the amount allowable as a credit exceeds the tax liability computed for the taxable year, the qualified taxpayer may make a one-time election for a refund that would be credited against other amounts due, if any, and the balance, if any, would be paid by the Controller, upon notice from the FTB, from the California Compost Tax Credit Fund, as authorized by section 39719 of the Health and Safety Code.

This bill would make the one-time election to request a refund irrevocable once made and is required to be made on the taxpayer's original, timely filed return, in a form and manner prescribed by the FTB, for the taxable year the credit is claimed.

This bill would require that qualified taxpayers report to the FTB, upon request, and in the form and manner specified, any information regarding allowed credits that is necessary for the FTB to administer the credit.

The bill includes Revenue and Taxation Code (RTC) section 41 requirements and provides that the goal, purpose, and objective of the credits are as follows:

- To help achieve the goal of net-zero greenhouse gas emissions through carbon sequestration in soils on working lands.
- To financially assist ranchers and farmers with composting practices that sequester carbon.

Detailed performance indicators for the Legislature to use in determining whether the credits meet the goals, purposes, and objectives shall include:

- The number of ranchers and farmers taking advantage of the credit.
- The acreage of the working lands in projects that are awarded the credit.
- The annual overall greenhouse gas reduction of the credit, broken down by dollar and by acre.
- Any reporting required by the State Air Resources Board of the DFA for the qualification of Greenhouse Gas Reduction Fund expenditures.

This bill would require the Legislative Analyst, in collaboration with the DFA and State Air Resources Board, to prepare and submit a report to the Legislature on the effectiveness of the credits.

To the extent data is available, the report shall include, but not be limited to, an analysis of the number of ranchers and farmers taking advantage of the credits, the impact of the credits on greenhouse gas emissions of the state on an annual basis, and the acreage of the working lands covered by projects approved for the credits.

This bill would require that the FTB provide any data requested by the Legislative Analyst to the extent that data is available. The RTC section 41 data reporting requirements would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information. Taxpayer information received by the Legislative Analyst would be subject to the general prohibition against disclosure of confidential taxpayer information.

This credit would be repealed on December 1, 2036.

Effective/Operative Date

This bill would be effective January 1, 2025, and specifically operative for taxable years beginning on or after January 1, 2025, and before January 1, 2036.

Federal/State Law

Federal and state 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, hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise be undertaken.

There is no comparable credit in federal or state law.

Federal law provides Clean Energy Tax Incentives for each of the following categories:

- Energy Generation and Carbon Capture
    - Production Tax Credit for Electricity from Renewables
    - Clean Electricity Production Tax Credit
    - Investment Tax Credit for Energy Property
    - Clean Electricity Investment Tax Credit
    - Low-Income Communities Bonus Credit
    - Credit for Carbon Oxide Sequestration
    - Zero-Emission Nuclear Power Production Credit
- Manufacturing
    - Advanced Energy Project Credit
    - Advanced Manufacturing Production Credit
- Vehicles
    - Credit for Qualified Commercial Clean Vehicles
    - Alternative Fuel Vehicle Refueling Property Credit
- Fuels
    - Clean Hydrogen Production Tax Credit
    - Clean Fuel Production Credit

Implementation Considerations

The FTB has identified the following implementation considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

This bill would allow a refundable tax credit under the CTL. Establishing this refundable tax credit program would have a significant impact on the FTB's programs and operations and require extensive changes to forms and systems. Currently, FTB's tax systems are not able to process business entity returns with a refundable tax credit. FTB obtained resources to begin implementing baseline infrastructure to allow a refundable credit for business entities and FTB's work on this will be complete as of January 1, 2026, for the 2025 tax year. Additional system changes necessary to address this tax credit would require 12 – 24 months to implement depending on complexity. As a result, FTB would be unable to process returns with this credit until the 2026 or 2027 tax year.

The bill is silent as to whether the CTL refundable tax credit would be allowed to reduce the regular tax below the alternative minimum tax. The lack of guidance could cause confusion for taxpayers, software providers, and the FTB. Further, the bill does not modify the hierarchy of CTL tax credit ordering. Note the hierarchy under the PITL includes refundable credits. The author may want to clarify the credit ordering.

The bill creates a new fund and specifies that refunds be paid from the newly created CA Compost Tax Credit Fund. Currently refunds are paid out of the Tax Relief and Refund Account. Processing refunds from two different funds could result in taxpayers receiving two separate checks. To avoid separate payments and to minimize taxpayer confusion, the author may consider granting FTB transfer authority of funds from the CA Compost Tax Credit Expansion Fund to the Tax Relief and Refund Account similar to the current process for Personal Income Tax refunds.

Technical Considerations

To provide clarity, the following changes are recommended:

- In Section 17052.9(a) and 23605(a), the term "subject to allocation by the DFA" should be clarified to make it clear that the taxpayer needs to have an allocation amount approved by the DFA.
- In Section 17052.9(h)(3)(A), the terms "ranchers and farmers" should be replaced with "taxpayers".
- In Section 17052.9(h)(3)(A), the term "taking advantage of the credits" should be replaced with "claiming the credits".

- The author may consider defining the following terms used throughout the bill, "agricultural land", "ranchlands", and "rangelands".

Policy Considerations

None noted.

LEGISLATIVE HISTORY

SB 1191 (Padilla, 2023/2024) would, under the PITL and CTL, adopt the federal gross income exclusion for any payment made for the purchase of certain energy credits. SB 1191 is currently in the Senate Appropriations Committee and has been placed in the suspense file.

SB 1301 (Becker, 2021/2022) would have, under the PITL and CTL, created a tax credit for purchases of certain tangible personal property used in manufacturing of specified clean energy products. SB 1301 did not pass out of the Assembly Revenue and Taxation Committee.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impacts:

Estimated Revenue Impact of SB 1135 as Amended April 25, 2024.
Assumed Enactment after June 30, 2024

Greenhouse Gas Reduction Tax Credit

($ in Millions)

Fiscal Year	Credit Claimed*
2024-2025	-$0.0
2025-2026	-$50
2026-2027	-$110

*The table above shows the impact on income and corporation tax revenue. This bill would require funds to be transferred from the California Compost Tax Credit Fund to the General Fund so that the net impact of the proposed credit on the General Fund would be zero.

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.

It is assumed that the maximum credit amount of $120 million per fiscal year, would be annually transferred to the California Compost Tax Credit Fund. Of the that amount, 20 percent, or $24 million, would be allocated and continuously appropriated to the Composting for Green Spaces Grant Program and Healthy Soil Program, which are separate and distinct from the credit. As a result, the aggregate amount of the credit allocated per fiscal year would be $96 million ($120 million - $24 million) plus any amount carried over from prior fiscal year.

It is expected that it would take about two years for the FTB and the California Department of Food and Agriculture to setup the infrastructure needed to administer this program. As a result, it is assumed that the first allocations would occur in 2026 and would include the 2025 and 2026 allocation amounts for a total of $192 million. After adjusting for two allocations per fiscal year, it is estimated that approximately $90 million in credit allocations would occur in the second half of the 2026 calendar year and $135 million would occur in the 2027 calendar year. As a result, the first credits would be claimed on the 2026 taxable year return filed in calendar year 2027.

It is assumed taxpayers would be able to use the credit to offset income and franchise tax in the taxable year the allocation is received. In addition, it is expected that 95 percent, or $85 million in credit, would be awarded to recipients who would make the onetime election for a refundable credit and the remaining $5 million in credit would be used to offset income and franchise tax liabilities. For those who do not make the refundable election, it is estimated that, 70 percent, or $3.2 million, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount 65 percent, or $2.1 million, would be claimed in the year generated and the remaining credit would be used in the subsequent years.

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

This bill would require funds to be transferred from the California Compost Tax Credit Fund to the General Fund so that the net impact of the proposed credit on the General Fund would be zero.

Deduction that would otherwise be Allowed

($ in Millions)

Fiscal Year	Revenue
2024-2025	+$0.0
2025-2026	+$4.0
2026-2027	+$8.7

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

To arrive at the offsetting tax effect of expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would no longer be able to deduct approximately $90 million in qualified expenses in taxable year 2026. Applying an average tax rate of 7 percent, results in an offsetting revenue gain of approximately $ 6.5 million in the 2026 taxable year.

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

LEGAL IMPACT

None noted.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

Support

Senate Revenue and Taxation Committee Analysis 04-19-24, the following organizations are in support of SB 1135:

California Association of Winegrape Growers (Co-sponsor)
People, Land and Food Foundation (Co-Sponsor)
Almond Alliance of California
California Chamber of Commerce
California Compost Coalition
California Environmental Voters (formerly CLCV)
California Farm Bureau
Californians Against Waste
Family Winemakers of California
Organic Fertilizer Association of California
Resource Recovery Coalition of California
Wine Institute

Opposition: None on file

ARGUMENTS

Proponents: None on file

Opponents: None on file

LEGISLATIVE CONTACT

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