



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Introduced:	02/17/11	Bill No:	<u>Assembly Bill 865</u>
Tax Program:	Property	Author:	Nestande
Sponsor:	Sunpeak Solar	Code Sections:	RTC 73
Related Bills:	ABx1 15 (Hill)	Effective Date:	Upon Enactment

BILL SUMMARY

This bill extends the new construction exclusion for active solar energy systems to improvements constructed through the 2032-33 fiscal year.

ANALYSIS

CURRENT LAW

The California Constitution, Article XIII A, Section 2(c)(1), grants the Legislature the authority to exclude the construction or addition of any active solar energy system from the definition of assessable new construction.

Section 73 of the Revenue and Taxation Code is the implementing statute for this new construction exclusion. Its provisions are scheduled to sunset after the 2015-16 fiscal year. Thus, under current law the exclusion applies to any system completed before January 1, 2017¹. However, after the exclusion sunsets, any solar energy system constructed previously excluded as new construction will remain exempt from property tax for so long as the property does not change ownership. Section 73 will be repealed by its own provisions on January 1, 2017.

PROPOSED LAW

This bill would extend the new construction exclusion to the 2032-33 fiscal year and provides for an automatic repeal of its provisions on January 1, 2034.

IN GENERAL

Property Tax System. Article XIII, Section 1 of the California Constitution provides that all property is taxable, at the same percentage of “fair market value,” unless specifically exempted, or authorized for exemption, within the Constitution. Article XIII A, Section 2 of the California Constitution defines “fair market value” as the assessor’s opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the “base year value.” Barring actual physical new construction or a change in ownership, annual adjustments to the base year value are limited to 2% or the rate of inflation, whichever is less. Article XIII A, Section 2 provides for certain exclusions from the meaning of “change in ownership” and “newly constructed” as approved by voters via constitutional amendments.

¹ This date is arguable due to conflicting language in Section 73. See comments section for a discussion.

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New Construction. The constitution does not define the terms “new construction” or “newly constructed.” Revenue and Taxation Section 70 defines these terms, in part, to mean:

Any addition to real property, whether land or improvements (including fixtures), since the last lien date.

Any alteration of land or any improvements (including fixtures) since the last lien date that constitutes a “major rehabilitation” or that converts the property to a different use.

A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

With respect to any new construction, the law requires the assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements qualifying as “new construction” and is added to the property’s existing base year value. When new construction replaces certain types of existing improvements, the value attributable to those preexisting improvements is deducted from the property’s existing base year value. (R&T Code §71)

New Construction Exclusions. Certain types of construction activity are excluded from assessment as “new construction” via constitutional amendment. Consequently, while these improvements may increase the value of the property, the additional value is not assessable.

Prop	Election	Subject	Code
8	November 1978	Disaster Reconstruction	§70(c)
7	November 1980	Active Solar Energy Systems	§73
23	June 1984	Seismic Safety (Unreinforced Masonry)	§70(d)
31	November 1984	Fire Safety Systems and Fire Egress	§74
110	June 1990	Disabled Access Improvements (Homes)	§74.3
127	November 1990	Seismic Safety Retrofitting & Hazard Mitigation	§74.5
177	June 1994	Disabled Access Improvements (All Properties)	§74.6
1	November 1998	Environmental Contamination Reconstruction	§74.7
13	June 2010	Seismic Safety Retrofitting & Hazard Mitigation (changes Proposition 23 and 127)	§74.5

Overview of Solar Energy New Construction Exclusion

An "active solar energy system" is defined in Section 73 as a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. An active solar energy system may be used for any of the following:

- Domestic, recreational, therapeutic, or service water heating.
- Space conditioning.
- Production of electricity.
- Process heat.
- Solar mechanical energy.

An active solar energy system includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items. "Parts" includes spare parts that are owned by the owner of, or maintenance contractor for, an active solar energy system for which the parts were specifically purchased, designed, or fabricated for installation in that system. Such a system includes only equipment used up to, but not including, the stage of transmission or use of the electricity.

An active solar energy system also includes pipes and ducts that are used exclusively to carry energy derived from solar energy. Pipes and ducts that are used to carry both energy derived from solar energy and energy derived from other sources may be considered active solar energy system property only to the extent of 75 percent of their full cash value.

An active solar energy system does not include auxiliary equipment, such as furnaces and hot water heaters, that use a source of power other than solar energy to provide usable energy. Dual use equipment, such as ducts and hot water tanks, that is used by both auxiliary equipment and solar energy equipment is considered active solar energy system property only to the extent of 75 percent of its full cash value.

Section 73 explicitly provides that exclusion does not apply to solar swimming pool heaters, hot tub heaters. By definition the exclusion does not apply to "passive" solar systems. And, the exclusion does not apply to wind energy systems.

LEGISLATIVE HISTORY OF SOLAR ENERGY NEW CONSTRUCTION EXCLUSION

Proposition 7 (SCA 28, Alquist) was approved by voters in 1980 and amended the California Constitution by giving the Legislature the authority to exclude from property tax assessment the addition of active solar energy systems as assessable new construction.

SB 1306 (Stats. 1980, Ch. 1245; Alquist) added Section 73 to the Revenue and Taxation Code to implement Proposition 7. Its provisions were operative for five fiscal years: 1981-82 through 1985-86.

AB 1412 (Stats. 1985, Ch. 878; Wyman), extended the exclusion for another five fiscal years: 1986-87 through 1990-91. It also required the Legislative Analysts Office to report to the Legislature by January 1, 1990 on the fiscal and economic effects of the exclusion.

SB 1311 (Greene) in 1989 proposed repealing the exclusion on January 1, 1990. SB 1311 was not heard in any committee.

AB 4090 (Wyman, Alquist) in 1990 proposed extending the exclusion through the 1993-94 fiscal year. AB 4090 passed both houses, but was vetoed by Governor Deukmejian. The Governor's veto messages stated that he supported efforts to encourage the development of solar energy in California, but the bill would have resulted in millions of dollars of property tax revenue loss to local entities in the high desert region of the state, and solar energy income tax credits were otherwise available. At that time, a major commercial project to build solar-electrical generating facilities (SEGS) in the Mojave Desert near Barstow in San Bernardino County was underway by Luz International Ltd.

SB 103 (Stats. 1991, Ch. 28; Morgan) extended the exclusion for three more fiscal years - 1991-92 through 1993-94. SB 103 added a new Section 73 to the code, since the prior Section 73 was repealed by its own provisions on January 1, 1991. However, SB 103 was urgency legislation effective on May 14, 1991 and drafted in a way that the continuity

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of the exclusion would not be affected. SB 103 included a provision to automatically repeal its provisions on January 1, 1995 absent future legislative action. No legislation was enacted prior to the repeal date so the exclusion was not available for five fiscal years (1994-95 through 1998-99) until AB 1755 was enacted as noted below.

SB 1553 (Alquist) in 1994 would have, in part, extended the exclusion indefinitely, however these provisions were amended out of this bill prior to its enactment.

AB 1755 (Stats. 1998, Ch. 855; Keeley) re-established the exclusion for six fiscal years: 1999-2000 through 2004-05. [SB 116 (Peace) in 1998 would have, in part, also re-established the exclusion. This bill was not enacted.]

AB 1099 (Stats. 2005, Ch. 193; Leno) extended the exclusion to the 2008-09 fiscal year. [That same year SB 1 (Murray) would have, in part, also extended the sunset date of the new construction exclusion. However, that provision was deleted from the bill. SB 1017 (Campbell) would have also extended the sunset date to the 2016-2017 fiscal year, but that bill was never heard in a committee.]

AB 1451 (Stats. 2007, Ch. 538; Leno) extended the exclusion to the 2015-16 fiscal year. It also allowed the value of the exclusion to apply to the initial purchaser of a new building that includes an active solar energy system, under specified conditions.

COMMENTS

- 1. Sponsor and Purpose.** Sunpeak Solar is sponsoring this bill to extend the sunset date to assist renewable energy developers in seeking better financing for solar projects with an in-service date beyond the 2016-17 fiscal year. The uncertainty of whether the property tax benefit of the solar energy new construction exclusion will be available for these projects exacerbates financing difficulties. Prospective lenders are unable to determine if project operating costs will include property taxes because of the current sunset date. Consequently, these lenders assume that property taxes will apply to these projects with construction dates beyond 2016.
- 2. Issue.** According to the author “[l]arge solar developments require several years of planning, permitting, development, financing and construction. Many of the projects presently announced will not have an in-service date prior to January 1, 2017. Because of the protracted period of time required to successfully develop a large solar project, many projects have uncertainty as to whether they will be able to avail themselves of the Section 73 exemption[sic]. The result is that lesser credit is available for the development of large solar facilities than otherwise would be the case, requiring either significantly more equity on the part of the project sponsor, or curtailment of project size and/or cancellation of projects because of economics. As a result, development and employment in the State is negatively impacted.”
- 3. Pending, Approved, and Past Large Scale Solar Projects in California.** According to the California Energy Commission “many large solar energy projects are being proposed in California's desert area on federal Bureau of Land Management (BLM) land. BLM has received right-of-way requests encompassing more than 300,000 acres for the development of approximately 34 large solar thermal power plants totaling approximately 24,000 megawatts. These projects have not yet reached the stage of an Application for Certification (AFC) with the California Energy Commission.” The Energy Commission website also lists solar thermal power plant projects over 50 MW that have reached AFC stage and which are under

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consideration. It also lists those projects that have been already approved, some of which the project developer has since withdrawn. Additionally, the history of earlier large solar projects in California is listed. <http://www.energy.ca.gov/siting/solar/index.html>

4. **In addition to the issue of future projects in planning stages, for those unfamiliar with the intricacies of California property tax law, there can be a general perception that a solar energy system currently excluded from assessment will become subject to property tax once the exclusion sunsets.** This perception must be overcome by those working towards encouraging investments in solar energy in California over the long term. To be clear, the repeal of Section 73 does not make a system that is benefiting from the exclusion immediately taxable. Generally, new construction exclusions remain in effect until the property changes ownership, at which point the entire property, including the portion of the property (or additional value) previously exempted from taxation under the new construction exclusion, will be reassessed at its current market value pursuant to the change in ownership provisions of Proposition 13. Thus, should Section 73 be repealed on January 1, 2017, a solar system that previously received the new construction exclusion will not become assessable, absent any other change in circumstances.
5. **Except for a five-year hiatus for fiscal years 1994-95 through 1998-99 the exclusion has been available since 1981.** This bill would ensure the continuity of the exclusion at least through the 2032-33 fiscal year.
6. **Ambiguity over the last date by which qualifying construction must be completed to receive the exclusion of Section 73.** Section 73(f) provides that “[t]his section applies to property tax lien dates for the 1999–2000 fiscal year to the 2032–33 fiscal year, inclusive” while Section 73(h) provides that “[t]his section shall remain in effect only until January 1, 2034, and as of that date is repealed. “ These provisions can result in three different interpretations as to the date by which construction must be completed to qualify for the exclusion. The possible interpretations span a two year period:
 - Construction completed by January 1, 2032 - the lien date for the 2032-33 fiscal year.
 - Construction completed by June 30, 2033 - the last day of the 2032-33 fiscal year.
 - Construction completed by January 1, 2034 – the last day the section of law remains in effect.

Board staff was faced with similar conflicting provisions when a prior Section 73 (as amended by Stats. 1991, Ch. 28 (SB 103)) was allowed to sunset and its provisions were repealed on January 1, 1995. At that time, subdivision (d) of former Section 73 read “[t]his section shall apply to lien dates for the 1991-92 to 1993-94 fiscal years, inclusive. For purposes of supplemental assessment, this section shall only apply to qualifying construction completed on or after January 1, 1991. This section shall remain in effect only until January 1, 1995, and of that date is repealed, unless a later enacted statute, which is chaptered before January 1, 1995, deletes or extends that date. “

In addressing the ambiguity, the staff made a determination in favor of the taxpayer and issued Letter to Assessors 1995/04 to administratively advise assessors to extend the exclusion to construction completed before the date the section of law was repealed (January 1, 1995). Given the need for certainty expressed by the sponsor, it would be helpful to combine these provisions into a single subdivision with a precise date. For example, "This section shall apply to qualifying construction completed on or before December 31, 2033, and as of January 1, 2034, is repealed."

7. **Section 73 is not a real property tax "exemption" for solar energy facilities, it is a new construction "exclusion."** The new construction exclusion was created in 1980 via Proposition 7 to provide that the construction or addition of an active solar energy system to an existing property, by itself, would not lead to a revaluation of the property for property tax purposes. The distinction between an exclusion and an exemption is important for several reasons: (1) the exclusion terminates if there is a transfer of the property resulting in change in ownership of the property (a reappraisal event), (2) the exclusion does not apply to any property that is under the assessment jurisdiction of the Board of Equalization – any such facility would be subject to property tax assessment, and (3) in the case of any locally assessed large scale solar project only the "improvements" are eligible for the exclusion, the land remains subject to property tax (and if the land is government owned, the land could become subject to property tax as a possessory interest. Generally, a taxable possessory interest exists when a taxpayer possesses an interest in government real property that is durable, independent, exclusive of the rights held by others in the real property and the interest provides a private benefit to the possessor).
8. **State assessed properties are not eligible for the new construction exclusion because it is only applicable to locally assessed property.** In *ITT World Communications, Inc. v. City and County of San Francisco* (1985) 37 Cal.3d 859, the California Supreme Court ruled that Proposition 13's (Article XIII A) assessment rollback, its 2 percent limit on annual assessment growth, and its limit on current market value assessment only upon a change in ownership or new construction did not apply to state-assessed property, only to locally assessed property. As a result, taxable property in California is now generally split into two major categories: locally assessed property subject to the assessment limitations of Article XIII A and state-assessed property not subject to the assessment limitations of Article XIII A. Thus, active solar energy systems owned by public utilities and subject to assessment by the Board of Equalization do not benefit from the new construction exclusion of Section 73; value of these properties would continue to be captured under the unitary approach to value.
9. **Related legislation.** ABx1 15 (Hill) also proposes unrelated amendments to Section 73 and makes uncodified legislative findings and declarations related to the extension of the exclusion to the purchaser of a newly constructed system provided that (1) the system is newly constructed or added, and (2) another taxpayer has not received an exclusion for that same active solar energy system. This bill is intended to address the issue that some newly constructed systems are sold in sale-leaseback arrangements (or other transactions) to a purchaser that might be able to avail themselves of federal tax benefits.

COST ESTIMATE

The BOE would incur some minor absorbable costs in informing and advising county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

Current law excludes from classification of “newly constructed” the construction or addition of any active solar energy system, as specified, through the 2015-16 fiscal year.

With existing law in place through the 2015-16 fiscal year, this bill would result in no immediate revenue impact. However, it is estimated that should existing law be allowed to expire, beginning with fiscal year 2016-17, the estimated annual loss in assessed value for residential and commercial property would be \$100 million.

In any year in which a large-scale solar power project is placed into service and qualifies for the new construction exclusion, the revenue impact could be substantially more for that particular year. As conditions, technology, and costs evolve, it is difficult to predict the number of projects that will come online after the 2016-17 fiscal year, nor the cost to construct such projects in the future.

REVENUE SUMMARY

This bill would result in no immediate revenue impact, but could reduce property tax revenues at the basic 1% property tax rate by \$1 million annually, beginning with the 2016-17 fiscal year. For any fiscal year in which a large-scale solar power project is completed and qualifies for the new construction exclusion, the revenue impact could be substantially more for that particular year.

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