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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date:	**Enrolled**	Bill No:	**Senate Bill 871**
Tax Program:	**Property**	Author:	**Committee on Budget and Fiscal Review**
Sponsor:	**Budget Bill**	Code Sections:	**RTC 73**
Related Bills:		Effective Date:	**Upon Enactment**

BILL SUMMARY

This bill extends the property tax new construction exclusion for active solar energy systems to improvements constructed through the 2023-24 fiscal year.

ANALYSIS

CURRENT LAW

The California Constitution[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.

Revenue and Taxation Code (RTC) Section 73 implements the new construction exclusion, which is available through the 2015-16 fiscal year. That section includes a repeal date of January 1, 2017.

Under current administrative guidance,[2] the exclusion applies to any system completed before January 1, 2017.[3] However, after the exclusion sunsets, any solar energy system previously excluded as new construction remains exempt from property tax for so long as the property does not change ownership.

PROPOSED LAW

This bill extends the new construction exclusion to the 2023-24 fiscal year and extends the repeal date to January 1, 2025.

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 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 consideration as a "change in ownership" and "newly constructed" as approved by voters via constitutional amendments.

[1] Article XIII A, Section 2(c)(1)
[2] Letter to Assessors 1995/04
[3] This date is arguable due to conflicting language in Section 73. See comment 4 for a discussion.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

New Construction. The California Constitution does not define the terms "new construction" or "newly constructed." RTC 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.[4]

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) (Forme)
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 (c*hanges Proposition 23 and 127)*	§74.5

Overview of Solar Energy New Construction Exclusion

An "active solar energy system" is defined in RTC 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.
- Heat processing.
- Solar mechanical energy.

[4] RTC Section 71

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 the sun and energy derived from other sources may be considered active solar energy system property only to the extent of 75% 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% of its full cash value.

RTC Section 73 explicitly provides that the exclusion does not apply to solar swimming pool heaters or hot tub heaters. By definition, the exclusion does not apply to “passive” solar systems. Lastly, 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 RTC Section 73 to implement Proposition 7. Its provisions were operative for five fiscal years: 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 Analyst’s Office to report to the Legislature by January 1, 1990 on the fiscal and economic effects of the exclusion.

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

AB 4090 (Wyman & Alquist, 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 state 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. The measure proposed a new RTC Section 73 since the prior statute sunset on January 1, 1991. However, SB 103 was urgency legislation effective on May 14, 1991 and drafted to avoid impacting the exclusion’s continuity. SB 103 included a sunset on January 1, 1995 absent future legislative action. No legislation was enacted prior to the sunset 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, 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: 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 extended the sunset date to the 2016-17 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 purchase of a new building that includes an active solar energy system, under specified conditions.

AB 865 (Nestande, 2011) would have extended the sunset date to the 2032-33 fiscal year in order to provide developers with certainty for their financiers that the exclusion would be available for their long term development plans. Because the exclusion includes a sunset, the questions arose whether the exclusion will be active when a project is completed. This uncertainty exacerbates financing difficulties. Because of the sunset, prospective lenders include property taxes as part of the project operating costs. That bill was held in the Assembly Appropriations Committee.

ABx1 15 (Stats. 2011, Ch. 3; Hill) expressly provides, via uncodified legislative findings and declarations, that a purchaser of a newly constructed active solar energy system that was sold in a sale-leaseback, partnership flip structure, or other transaction, is eligible to receive the property tax new construction exclusion for the system.

COMMENTS

1. **Purpose.** This budget trailer bill ensures that the new construction exclusion will be in place through fiscal year 2023-24 and extends the repeal date to January 1, 2025.
2. **Except for a five-year hiatus for fiscal years 1994-95 through 1998-99, the exclusion has been available since 1981.** This bill ensures the continuity of the exclusion.
3. **Pending, Approved, and Past Large Scale Solar Thermal Projects in California.** By 2020, 33% of retail sales of electricity must be from renewable energy resources. Solar energy will be a main source of renewable power. The California Energy Commission website lists solar power plant projects over 50 MW and includes the history of earlier large solar projects in California. Additionally, information on the status of all projects is available.
4. **A solar energy system currently excluded from assessment remains so after the exclusion sunsets.** Section 73's repeal would not make a system benefiting from the exclusion immediately taxable. On occasion, there is a misperception that the system becomes taxable if the exclusion sunsets. Generally, new construction exclusions remain in effect until the property changes ownership, at which point the entire property, including the new construction exclusion portion of the property (or additional value), will be reassessed to its current market value pursuant to Proposition 13's change in ownership provisions. Thus, if Section 73 sunsets 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. **Ambiguity over eligibility completion date.** Section 73(g) provides that "[t]his section applies to property tax lien dates for the1999–2000 fiscal year to the 2023–24 fiscal year, inclusive" while Section 73(i) provides that "[t]his section shall remain in effect only until January 1, 2025, and as of that date is repealed." These provisions result in different interpretations as to the date by which construction must be completed to qualify for the exclusion:
   - January 1, 2023 (the lien date for the 2023-24 fiscal year);
   - June 30, 2024 (the last day of the 2023-24 fiscal year); or
   - January 1, 2025 (the last day the section of law remains in effect).

   BOE staff was faced with similar conflicting provisions when a prior version of 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, former Section 73 (d) 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 statue, which is chaptered before January 1, 1995, deletes or extends that date."

   To address the ambiguity, the staff interpreted the statute 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 repeal date (January 1, 1995). Given the need for certainty, combining these provisions into a single subdivision with a specific date is helpful. For example, "This section shall apply to qualifying construction completed on or before December 31, 2024, and as of January 1, 2025, is repealed."

6. **Section 73 is not a real property tax "exemption" for solar energy facilities, but 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 a property's change in ownership (a reappraisal event); (2) the exclusion does not apply to any property that is under the BOE's assessment jurisdiction – 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, while the land remains subject to property tax.[5]

7. **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% limit on annual assessment growth, and its limit on current market value assessment only upon a change in ownership or new construction did not

[5] If the land is government owned, the land could become subject to 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.

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 Article XIII A assessment limitations and state-assessed property not subject to those assessment limitations. Thus, active solar energy systems owned by public utilities and subject to BOE assessment do not benefit from the Section 73 new construction exclusion; value of these properties would continue to be captured under the unitary approach to value.

COST ESTIMATE

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

REVENUE ESTIMATE

Current law excludes from classification as "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 fiscal year 2015-16, this bill would result in no immediate revenue impact. However, if the exclusion was allowed to expire, then this bill results in a revenue loss beginning with the 2016-17 fiscal year. Based on statistics published by the California Solar Initiative Project, the estimated annual loss in assessed value for residential and commercial property that qualify for the property tax exclusion for solar energy amounts to $900 million for each year the sunset date is extended.

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, or 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 $9 million annually, beginning with the 2016-17 fiscal year, since there would have been a revenue gain if the exclusion had been allowed to sunset. 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.

Analysis prepared by:	Rose Marie Kinnee	916-445-6777	06/18/14
Revenue estimate by:	Chris Butler	916-445-0840	
Contact:	Michele Pielsticker	916-322-2376	

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