# STATE BOARD OF EQUALIZATION
# STAFF LEGISLATIVE BILL ANALYSIS

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| Date Amended: | **07/13/09** | Bill No: | **SB 832** |
| Tax: | **Sales and Use** | Author: | **Committee on Environmental Quality** |
| Related Bills: | | | |

## BILL SUMMARY

This bill would amend, among other things, the definition of "project," "pollution," and "participating party" in the Health and Safety Code for purposes of authorizing the California Pollution Control Financing Authority (CPCFA) to provide financing to participating parties for various projects and pollution control facilities. These definitional changes could impact the sales and use tax exclusion provided in Revenue and Taxation Code Section 6010.10.

## ANALYSIS

### CURRENT LAW

Under existing law, California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt from taxation by statute. This tax is imposed on the retailer who may collect reimbursement from the customer if the contract of sale so provides. Under the law, it is presumed that gross receipts from a particular sale of tangible personal property are subject to tax, unless the seller can establish either that the sale was not a retail transaction or that the sale is subject to an exemption.

Revenue and Taxation Code Section 6010.10 provides that "sale" and "purchase" do not include any transfer of title of tangible personal property constituting any project to the CPCFA by any participating party, nor any lease or transfer of title of tangible personal property constituting any project by the authority to any participating party, when the transfer or lease is made pursuant to Division 27 (commencing with Section 44500) of the Health and Safety Code. The terms "project," "pollution control facility," and "participating party" are defined in Section 6010.10 by reference to Health and Safety Code Sections 44506 and 44508.

Under existing law, "public agencies" are not included within the definition of "participating party" and would not be entitled to finance qualified projects with the CPCFA. In addition, existing law does not specifically include within the term "pollution" such things as salt or other naturally occurring substances or manmade substances that must be removed to provide safe drinking water. Therefore, under existing law, a project designed to remove salt water, for example, appears not to qualify as a project for which a sales and use tax exclusion would apply even if it is structured within the terms of the sales and use tax exclusion.

### PROPOSED LAW

This bill would make various changes to the financial and administrative provisions of the California Pollution Control Financing Act, and would, among other things, redefine the terms "project," "pollution," and "participating party."

The bill would broaden the definition of “pollution” to clarify that any natural or manmade substance that must be removed to provide safe drinking water shall be regarded as “pollution.”

In addition, it would broaden the definition of “participating party’ to include any public agency.

As an urgency bill, the bill would become effective immediately.

### BACKGROUND

The CPCFA (which consists of three members: the Director of Finance, the State Controller, and the State Treasurer) was created in 1972 and provides financial assistance in a variety of forms, including tax exempt bonds for qualifying waste and recycling facilities, grants and loans to clean up contaminated lands, small business loan assistance and tax exempt bonds for certain industrial facilities.

Its tax-exempt bond financing program gives California businesses help with acquisition or construction of qualified pollution control, waste disposal, or recycling facilities, and the acquisition and installation of new equipment. Typically, tax-exempt bond issues exceed $2.5 million.

CPCFA’s program provides loans and grants of between $50,000 and $5 million for the cleanup of contaminated property that results in housing.

Through small business loans, CPCFA also helps small-business borrowers obtain loans through participating financial institutions. CPCFA also provides tax-exempt industrial development bonds for qualified manufacturing and processing companies. CPCFA Industrial Development Bonds can be used for a variety of pollution control, solid waste and recycling facilities. Generally, Industrial Development Bonds are issued for projects costing at least $1 million up to a maximum of $10 million.

The sales and use tax exclusion relating to CPCFA was first added to law through an uncodified section in AB 3750, (Stats. 1976, Ch. 1384) and was later added to the Revenue and Taxation Code in 1981. According to the CPCFA, since financing of these projects are done primarily through federal tax exempt activity bonds, no project has been structured so as to qualify for the sales and use tax exclusion.

### IN GENERAL

In a typical transaction involving the financing of projects with CPCFA, persons who are applying for financing pay an application fee and are required to obtain a resolution from the CPCFA Board approving the proposed transaction. If approved, that person is regarded as a participating party, and the transaction is regarded as a “project” for purposes of the Health and Safety Code.

Although no transactions have occurred that would warrant an exclusion from the sales or use tax, in order to qualify, a typical transaction would occur like this: The participating party would purchase the property without payment of tax, and resell the equipment to CPCFA. This transfer would be excluded from sales and use taxes as a transfer from a participating party to CPCFA.

The applicant and CPCFA would then enter into a lease, whereby CPCFA transfers to the applicant the property. Upon complete installation of all the property, ownership of the property would be transferred from CPCFA to the participating party. This transfer would also be excluded from sales and use taxes.

The sales-lease-back works in this way: CPCFA would purchase the specified equipment (tangible personal property, not real property) on behalf of the participating party. CPCFA would finance that purchase through a bond or loan. The participating party would then lease the equipment from CPCFA and the lease payments pay for the bond or loan. The lease would stay in existence only for a couple of weeks, from the time of purchase until the equipment is placed in use. Under the Sales and Use Tax Law, CPCFA would not have to pay sales tax on the equipment it purchases, nor collect use tax on its lease receipts.

**COMMENTS**

1. **Sponsor and purpose.** This bill is sponsored by the State Treasurer. Its purpose is to update the law, which has not been updated since 1975, to reflect changes in business practices, program updates, and federal tax law.

2. **Any change to the Health and Safety Code's definition of "project," "pollution control facility," or "participating party" could have a direct sales and use tax implication.** The exclusion provided in Revenue and Taxation Code Section 6010.10 is linked directly with the terms "project," "pollution control facility," and "participating party" as defined in the Health and Safety Code provisions. If those terms are either broadened or narrowed within the context of the Health and Safety Code, a direct state and local sales and use tax revenue loss or gain can result. However, the CPCFA has indicated that no project has yet been structured so as to qualify for the sales and use tax exclusion, and does not anticipate that the structure of future projects would significantly change from how they are currently structured.

   Since this bill would broaden the definitions of "participating party" to include public agencies, and "pollution" to include "any natural or manmade substance that must be removed to provide safe drinking water," the potential for a direct sales and use tax state and local revenue loss would exist. The extent of that loss would be dependent on the number of new projects approved by the CPCFA pursuant to this bill and the dollar amount of machinery, equipment or other tangible personal property sold, leased or transferred pursuant to Section 6010.10.

**COST ESTIMATE**

Some absorbable administrative costs would be incurred in notifying retailers, revising the Board's publications, and answering inquiries from taxpayers.

**REVENUE ESTIMATE**

Although this bill provides an incremental expansion of CFCFA's authority to finance additional projects, we do not anticipate any related sales and use tax implications, since to date, no project has been structured in such a manner to qualify for the exclusion.

CPCFA adopted 11 projects in 2008 amounting to $265.5 million. All of these projects consisted of solid waste or hazardous waste disposal projects, which include waste recovery facilities, landfills, and waste to energy facilities, material recovery facilities, and transfer stations; and the purchase of collection vehicles and residential waste containers.

The average value of each 2008 approved project amounted to $24.1 million. We found that the average cost of a used waste collection vehicle amounts to $54,500, and the cost of a new waste collection vehicle could be as high as $210,000. We do not have any information that would indicate whether a public agency would structure its transactions to qualify for the sales and use tax exclusion. However, to illustrate, we have provided an estimate below of the sales and use tax that *could* be associated with a solid waste disposal project by a public agency. We have also included an estimate of the sales and use tax associated with a desalination plant, such as one currently approved for construction in Carlsbad California (however, we have no information that indicates that such a project would be constructed in a manner qualifying for the sales and use tax exclusion), as follows:

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| **Desalination Project** | $300,000,000 |
| Less Labor (50% of contract cost) | (150,00,000) |
| Taxable gross per contract cost | $150,000,000 |
| | Revenue Loss |
| State (6.00%) | $9,000,000 |
| Fiscal Recovery Fund (0.25%) | 375,000 |
| Local (2.75%) | 4,125,000 |
| **Total** | **$ 13,500,000** |

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| **Solid Waste Disposal Project** | $24,100,000 |
| Less Labor (50% of contract cost) | (12,050,000) |
| Taxable gross per average contract cost | $12,050,000 |
| | Revenue Loss |
| State (6.00%) | $723,000 |
| Fiscal Recovery Fund (0.25%) | 30,000 |
| Local (2.75%) | 332,000 |
| **Total** | **$ 1,085,000** |

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| **New waste collection truck cost** | $ 210,000 |
| | Revenue Loss |
| State (6.00%) | $12,600 |
| Fiscal Recovery Fund (0.25%) | 500 |
| Local (2.75%) | 5,800 |
| **Total** | **$ 18,900** |

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| **Used waste collection truck cost** | $ 54,500 |
| | Revenue Loss |
| State (6.00%) | 3,300 |
| Fiscal Recovery Fund (0.25%) | 100 |
| Local (2.75%) | 1,500 |
| **Total** | **$ 4,900** |

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***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 Board's formal position.***