



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/26/06	Bill No:	AB 1631
Tax:	Sales and Use	Author:	Klehs
Related Bills:			

BILL SUMMARY

This bill would provide a sales and use tax exemption for the sale and purchase of a fuel cell vehicle, as defined, and a fuel cell system, as defined, sold or leased to a qualified person (e.g., public transit agency), as defined.

Summary of Amendments

Since the previous analysis, this bill was amended to provide a sales and use tax exemption on the sale or purchase of a fuel cell vehicle, as defined, and a fuel cell system, as defined, that is sold or leased to a qualified person, as defined. This bill was also amended to remove the January 1, 2005 operative date.

ANALYSIS

Current Law

Under existing law, the sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption in this state of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies to the sale or use of tangible personal property in this state, unless the sale or use is specifically exempted or excluded from tax.

With the exception of certain sale and leaseback transactions, current law does not contain an exemption for fuel cell transit buses or fuel cell systems sold to or purchased by a public agency, public transit district, or public or local regional transportation entity. Therefore, when a public agency, public transit district, or public local or regional transportation entity purchases a fuel cell transit bus for use in their operations, tax applies to the purchase price of that bus.

Leases

Leases of tangible personal property, including buses, may be subject to tax, unless the sale or use is specifically exempted or excluded from tax. However, the taxability of leases of mobile transportation equipment (MTE) differs from the taxability of leases of other tangible personal property. Under current law, leases of MTE are specifically excluded from the definition of a "sale." MTE includes equipment such as railroad cars, buses, trucks, tractors, aircraft and ships. The lessor of MTE is regarded as the consumer of the property and tax applies to the retail sale to the lessor, *unless* the lessor makes a timely election to report tax on the fair rental value of the property.

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This bill would exempt from the tax a lease of a fuel cell bus to a qualified person. For purposes of the exemption, the lessor may elect to report tax on the fair rental value of the MTE, and the subsequent lease of the MTE to a qualified person providing an exemption certificate to the lessor would not be subject to tax.

Sale and Leaseback

Current law provides for a sales and use tax exemption for the sale and leaseback of public passenger transportation vehicles (including public transit buses) and related equipment by a qualified person. The Legislative intent of this exemption was to facilitate certain financing transactions commonly known as a “sale and leaseback.”

Revenue and Taxation Code section (Section) 6368.8, as added by AB 984 (Stats. 2001, Ch. 592), provides a sales and use tax exemption for public passenger transportation vehicles sold or leased by a transit authority, special district, or governmental entity and leased or subleased back to the authority, district, or entity. Public passenger vehicles include a vehicle or vessel and any related equipment and accessories used to provide public transportation services, including, but not limited to, bus and van fleets, ferry boats, rail passenger cars, locomotives, and other rail vehicles.

To qualify for the exemption, the public passenger vehicle must be sold or leased by a transit authority, special district, or governmental entity, the entity must have paid sales tax reimbursement or use tax with respect to the acquisition of the public passenger vehicle, and the public passenger vehicle must be leased or subleased back to the entity. SB 760 (Stats. 2003, Ch. 597) amended Section 6368.8 to extend the sunset date due to expire on January 1, 2004, to January 1, 2009.

Proposed Law

This bill would add Section 6368.11 to exempt from the sales and use tax the sale or purchase of a “fuel cell vehicle,” or a “fuel cell system” used exclusively for the purpose of upgrading a fuel cell vehicle, sold or leased to a “qualified person.” This bill provides the following definitions:

“Fuel cell vehicle” means a heavy-duty public transit bus, of no less than 40 feet in length, whose primary source of power is derived from a fuel cell system.

“Fuel cell system” means a fuel cell system that chemically combines hydrogen and oxygen to generate electricity to energize electric drive motors.

“Qualified person” means a public agency, public transit district, or a public local or regional transportation entity organized under the laws of this state.

As a tax levy, this bill would become effective immediately upon enactment.

Background

California Fuel Cell Partnership

In April 1999, the California Fuel Cell Partnership (CaFCP) was formed to help advance fuel cell-powered vehicles, including fuel cell buses, in California. The CaFCP was created at the request of both the California Air Resources Board for a demonstration program and industry’s interest in investigating the feasibility and market potential of

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fuel cell vehicles. The CaFCP has evolved into a collaboration of auto manufacturers, energy companies, fuel cell companies, and government agencies whose goals include demonstrating fuel cell technology by operating and testing fuel cell passenger cars and transit buses under real-world conditions in California.

Three California transit agencies are members of the CaFCP and will demonstrate a total of seven fuel cell electric buses in regular transit service. Those agencies are: Alameda-Contra Costa Transit District (AC Transit), SunLine Transit Agency, and Santa Clara Valley Transportation Authority.

Zero Emission Bus Requirement

In February 2000, the California Air Resources Board (ARB) adopted a Transit Bus Fleet Rule, which includes zero-emission bus demonstration and zero-emission bus acquisition requirements. The zero-emission bus regulation can be found in title 13, California Code of Regulations, section 2023.3. This regulation defines a “zero-emission bus” as producing zero exhaust emissions of any criteria or precursor pollutant under any and all possible operational modes and climates. **Zero-emission buses include hydrogen-fuel cell buses**, battery electric buses, and electric trolley buses with over-head twin-wire power supply.

The zero-emission requirements are applicable to large transit agencies only (transit agencies with an active fleet of more than 200 urban transit buses).

There are five large transit agencies required to implement a **zero-emission bus demonstration project**. Of the five transit agencies, four have selected fuel cell buses to demonstrate and are participating in joint fuel cell demonstrations. Those four agencies are: AC Transit, Golden Gate Bridge Highway and Transportation District, San Mateo County Transit District, and Santa Clara Valley Transportation Authority.

Large transit agencies are also required to implement the **zero-emission purchase requirements** on a phased-in schedule. For large transit agencies on the diesel fuel path, a 15 percent aggregate total of all bus acquisitions from model years 2008 through 2015 must be zero-emission buses. For large transit agencies on the alternative fuel path, the zero-emission bus acquisition requirement starts with model year 2010 and runs through model year 2015.

Prior Legislation

There have been several bills considered in the past to provide an exemption for sales of transit vehicles sold to public transit agencies. The more recent bills include:

AB 1884 (Lowenthal, 1999-2000) – would have provided a partial sales and use tax exemption for the sale or purchase of a public safety vehicle, as defined, purchased by a city, county, city and county, or special district responsible for public safety. This bill was held in the Assembly Appropriations Committee.

SB 677 (Polanco, 1999-2000) – would have provided a partial sales and use tax exemption, beginning January 1, 2000 and ending December 31, 2004, for sales of transit vehicles to the Los Angeles County Metropolitan Transportation Authority. This bill was held in the Senate Revenue and Taxation Committee.

SB 2068 (Solis, 1999-2000) - would have provided a partial sales and use tax exemption for the sale of any natural gas, electric, or fuel cell powered bus or truck for

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use exclusively in public transit, school bus, or public works service. This bill died in the Senate Revenue and Taxation Committee.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the AC Transit in an effort to improve the environmental health and the quality of life in the communities it serves. According to the sponsor, public transit agencies must find technological solutions to environmental challenges. Reducing pollution from their diesel fleets is good, but is not good enough. According to the author, "Public transit fuel cell technology buses provide a real-world testing environment for fuel cell vehicles, hydrogen fuel, and the environmental impact. It also exposes more people to the advantages of fuel cell vehicles providing first-hand experience for drivers, maintenance staff, and passengers. If this bill is not enacted to provide an exemption for fuel cell buses, the strength and value of public transit agencies' hydrogen development projects will be seriously compromised."
- 2. The April 26, 2006 amendments** delete the January 1, 2005 operative date and make technical, nonsubstantive changes. **The September 7, 2005 amendments** gutted the prior version of the bill which would have provided a sales and use tax exemption on the sale or purchase of tangible personal property sold to a qualified person, as defined, in the manufacture of alternative fuel prototype buses pursuant to a qualified research and development contract, as defined. The bill would now provide a sales and use tax exemption on the sale or purchase of a fuel cell vehicle, as defined, and a fuel cell system, as defined, that is sold or leased to a qualified person, as defined.
- 3. Definition of a fuel cell vehicle needs clarification.** This bill defines a fuel cell vehicle as a heavy-duty public transit bus, of no less than 40 feet in length, whose primary source of power is derived from a fuel cell system. The proposed exemption would apply to the sale or lease of a fuel cell bus to a public agency, public transit district, or a public local or regional transportation entity and also apply to any accessories installed prior to delivery that are sold in connection with the sale of the bus. These items might include motion detectors, onboard data collection systems, and radios.

With the exception of upgrading a fuel cell system, any accessories installed after delivery that are not part of the sale of the bus would not qualify for the exemption. While it is a common practice for public transit agencies to later install accessories such as GPS communication devices and fare collections systems, these upgrades would not be exempt from the tax. Since these items are necessary in the operation of a public transit bus, does the Legislature want such items included in the exemption?

In addition, since the proposed exemption applies to the sale of a public transit bus powered by a fuel cell system, perhaps the definition should contain certain references. For example, public transit buses are defined under Section 642 of the California Vehicle Code. Also, other regulations classify a hydrogen-fuel cell bus as a zero-emission bus and provide definitions. Perhaps the definition of a fuel cell vehicle should contain a reference to a hydrogen-fuel cell bus and a definition of a zero-emission bus pursuant to the ARB regulation.

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Additionally, this bill requires that a public transit bus be at least 40 feet in length. As the fuel cell technology progresses and more transit districts purchase fuel cell powered buses, there is the possibility that some of these buses will be less than 40 feet in length. Perhaps the length requirement in the bill should be removed or at least reduced to a length of a small or medium size transit bus.

- 4. Definition of fuel cell system also needs clarifying.** A fuel cell system is defined as a fuel cell system that chemically combines hydrogen and oxygen to generate electricity to energize drive motors. The bill also states that the fuel cell system is to be used exclusively for the purpose of upgrading a fuel cell vehicle.

The U.S. Department of Energy defines a fuel cell system as a compact electrical generator that uses hydrogen (or hydrogen-rich fuel) and oxygen to create electricity by an electrochemical process. According to that agency, most fuel cell systems consist of four basic components: fuel cell stack, fuel processor, current converter, and a heat recovery system. Perhaps the definition of a fuel cell system should list the various components and subsystems that are contained within the system and/or are necessary for the operation of the fuel cell system. Additionally, Board staff notes that the definition uses the term “fuel cell system” which is being defined.

- 5. Should “upgrade” of a fuel cell system be expanded?** The fuel cell system interacts with electric drive motors and electric drive train components as well as peripheral equipment such as low/high voltage batteries, inverters, reactors, and hardware and software. These items are not part of the fuel cell system. When upgrading a fuel cell system, some of these items may also require upgrading but under this bill these items would not qualify for the exemption. Does the Legislature want the definition amended to include such items?

- 6. Definition of a qualified person needs clarifying.** This bill defines a qualified person to mean a public agency, public transit district, or a public local or regional transportation entity organized under the laws of this state. With respect to the term “public agency,” would this term include a city, city and county, a county, the State of California, or any public agency, district, or authority organized under the laws of this State? Clarification of this term would help the Board to administer the exemption. With respect to the terms public transit district and public local or regional transportation entity, it appears that these public entities are established under the California Public Utilities Code. Perhaps the definition should contain a reference to certain sections of that code.

Board staff is willing to work with the author’s office to draft amendments to address the above concerns.

COST ESTIMATE

Some costs would be incurred in notifying affected taxpayers and revising the regulation and pamphlets. These costs would be insignificant (under \$10,000).

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REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill would exempt from the sales and use tax the sale or purchase of a “fuel cell vehicle,” or a “fuel-cell system” used exclusively for the purpose of upgrading a fuel cell vehicle, sold or leased to a “qualified person.”

We know of four fuel-cell buses that have been placed in service under a demonstration program conducted by the California Fuel Cell Partnership (CaFCP), an organization formed to help advance fuel cell powered vehicles, including fuel cell buses in California. Alameda-Contra Costa Transit District (AC Transit), a member of the CaFCP, contracted with ISE Research Corporation and Van Hool NV to acquire four fuel cell buses, one of which was acquired on behalf of SunLine Transit Agency. All four buses were delivered by December 2005 and placed into demonstration by February 2006. The average cost of each bus amounted to \$3,140,000. According to representatives from ISE Research and AC Transit, the value of fuel-cell systems used exclusively to upgrade an existing fuel cell vehicle could cost as much as \$1 million, which includes integrating the fuel cell into the vehicle.

While this bill would not exempt those transactions since they have already taken place, any future sales and purchases would have a revenue impact of approximately \$249,000 (\$3,140,000 x 7.93%) in state and local sales and use tax for each fuel-cell bus and \$79,000 (\$1 million x 7.93%) for each fuel-cell system.

Revenue Summary

There is no immediate revenue loss from this bill. However, as new fuel-cell buses are purchased and placed into service by public transit districts and fuel-cell systems are replaced, the revenue impact from each new fuel-cell bus or fuel-cell system would be as follows:

	<u>Revenue Loss</u>	
	<u>Each Fuel-Cell Bus</u>	<u>Each Fuel-Cell System</u>
State (5.00%)	\$157,000	\$50,000
Fiscal Recovery (0.25%)	7,800	2,500
Local (2.0%)	62,800	20,000
District (0.68%)	<u>21,400</u>	<u>6,800</u>
Total	<u><u>\$249,000</u></u>	<u><u>\$79,300</u></u>

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