Draft

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**6/04/07**	Bill No:	**AB 1451**
Tax:	**Property**	Author:	**Leno, et al**
Related Bills:	**AB1239 (Garrick)**		

BILL SUMMARY

This bill would, with respect to the new construction exclusion for active solar energy systems:

- Extend the sunset date from the 2008-09 fiscal year to the 2015-16 fiscal year.
- Allow the value of the exclusion to apply to the initial purchaser of a new building.
- Extend the exclusion to transmission and distribution related equipment, if the electricity is being transmitted to an electrical corporation or local publicly owned electric utility with which the owner has an electricity purchase agreement and is not receiving net energy metering.

SUMMARY OF AMENDMENTS

The amendments: (1) prohibit the value of the exclusion to apply to the initial purchaser of a new building if the owner-builder claimed the exclusion for the same system; (2) limit the exclusion for transmission and distribution related equipment to equipment, poles, towers, and structures other than buildings; and (3) make the provisions of this bill severable.

ANALYSIS

CURRENT LAW

New Construction Exclusion – Active Solar Energy Systems. 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. The property tax exclusion for new active solar energy systems is scheduled to sunset after the 2008-09 fiscal year. However, after the exclusion sunsets, any solar energy system constructed remains exempt from property tax for so long as the property does not change ownership.

Change in Ownership Terminates New Construction Exclusion. After a change in ownership, the entire property, including the portion of the property (or additional value) previously exempted from taxation via the new construction exclusion, is subject to reassessment to its current market value. Consequently, in the case of properties constructed for immediate resale, there is limited, if any, tax benefit to a new construction exclusion.

Transmission and Distribution Equipment. Section 73 (c) provides that exclusion only applies to equipment used up to, but not including, the stage of the transmission or use of the electricity.

PROPOSED LAW

Sunset Date. This bill would extend the new construction exclusion to the 2015-16 fiscal year and provides for an automatic repeal of its provisions on January 1, 2017.

Solar Energy Systems Incorporated into New Buildings – Exclusion Extended to Initial Purchaser. In the case where a solar energy system is incorporated by an owner-builder in the initial construction of a new building that the owner-builder does not intend to occupy or use (i.e., offered for sale, such as new homes in a subdivision) the exclusion would apply to the building's first buyer if the owner-builder did not request and receive the exclusion for the same active solar energy system. Specifically, the new base year value of the building established as a result of the change in ownership would be reduced to reflect that portion of the value attributable to the active solar energy system. Thereafter, any subsequent change in ownership of the property would end the exclusion of the value of active solar energy system from property tax. If the solar energy system received any rebates, appropriate adjustments would be made.

The Board would be required to prescribe the claim form, in consultation with the California Assessors' Office, to continue the new construction exclusion after the change in ownership.

Transmission and Distribution Equipment. This bill would amend Section 73(c) to allow, rather than prohibit, the exclusion to be extended to certain equipment related to the transmission and distribution of the electricity produced, but only if (1) the owner of the solar energy system does not receive net energy metering and (2) the owner is a private energy producer with an electricity purchase agreement to supply an electrical corporation or local publicly owned electric utility. In this case, the exclusion would also apply to transmission and distribution equipment, poles, towers, and structures, other than buildings used to convey electricity up to the point of interconnection with the utility transmission or distribution network. Dual use transmission and distribution equipment, poles, towers, and structures other than buildings that are part of an active solar energy system would be excluded only to the extent of 75 percent of the full cash value.

Effective Date. The amendments made by this bill are prospective and its provisions would apply beginning with any qualifying improvements completed on of after January 1, 2008.

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.

New Construction. The constitution does not define the term "new construction." Revenue and Taxation Section 70 defines it, 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 improvements (including fixtures) since the 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 is 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	§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

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. Such a system does not include solar swimming pool heaters, hot tub heaters, passive energy systems, or wind energy systems.

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.

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 construction of active solar energy systems.

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 the 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 May 14, 1991 and drafted so the continuity 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.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by PV now. Its purpose is to ensure that there is an actual tax benefit for newly built homes constructed with a solar energy system, ensure investors that the exclusion will still be in effect for long planned commercial scale solar energy projects, and extend the exemption to the transmission elements of these projects.

2. **Amendments.** The **June 6** amendments prohibit the post-change in ownership exclusion if the owner-builder claimed the exclusion for the same system to prevent "double dipping" and (2) make its provisions severable as some have questioned the constitutionality of this provision. In addition, in regards to the provision to extend the exclusion to transmission and distribution related equipment, if the electricity is being transmitted to a utility, limits the exclusion to equipment, poles, towers, and structures other than buildings. The **May 16** amendments added the provisions of this bill as they related to rebates, provided that the Board would consult with the California Assessors' Association in prescribing the manner, documentation, and form for claiming the exclusion, and expressly provided the amendments made by this bill apply prospectively. The **May 8 amendments** expanded the provisions of this bill from single family residences to all buildings and modified the provisions related to transmission and distribution equipment.

3. **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 through 2016.

4. **New construction exclusions remain in effect until the property changes ownership.** 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 via the new construction exclusion, is subject to reassessment to current market value pursuant to the change in ownership provisions of Proposition 13.

5. **In the case where a building is built for immediate sale, this bill provides that the exclusion would continue to apply to the initial purchaser of the building.** Without these provisions, the new construction exclusion is ineffectual for any new building that is not intended to be occupied or used by the owner-builder. Once a building is sold (i.e., changes ownership) the entire property must be reassessed to its current market value for purposes of Proposition 13. Opponents of the measure argue that such an extension to an initial purchaser requires a specific constitutional amendment. Proponents state that allowing the exclusion to be extended only when it was not claimed by the original owner-builder falls within the spirit of the existing constitutional authorization to exclude from the property tax the value added by an active solar energy system. This bill and AB 1239 (Garrick) of this legislative session set a precedent of extending the benefits of the new construction exclusion after a change in ownership for the first purchaser only. AB 1239 relates to fire sprinkler, fire safety, and fire detection systems.

6. **This bill would require an assessor to subtract out the incremental value of qualified improvements when a new building that incorporates an active solar energy system is initially constructed.** This bill would set a precedent for excluding the value of particular components of an entirely new property. Specifically, the new base year value of the building established as a result of the change in ownership would be reduced to reflect that portion of the value attributable to the active solar energy system.

7. **The active solar energy exclusion was created in 1980 to encourage the development and construction of major commercial solar energy projects by private parties.** At that time, complete solar energy systems for homes were not common. The most common residential use of solar energy technology, those for swimming pool heaters or hot tub heaters, was specifically excluded for the exclusion in the statutory implementation of the exclusion. Today, some residential subdivisions incorporate active solar energy systems in the initial construction of the home either as a standard feature or as an optional upgrade.

8. **Electricity produced for a public utility.** This bill expands the exclusion to equipment related to the transmission and distribution of the electricity produced by the solar energy system but only if the electricity is transmitted to a utility for inclusion in the utility's transmission or distribution network, Presumably, these provisions are intended for major commercial scale solar energy projects the primary purpose of which is to sell the resulting electricity. To aid in the administration of this provision, the treatment of a solar energy system with a dual purpose would benefit from clarification. If a property with a solar energy system both consumes the electricity produced for its own purposes, such as a manufacturing plant, and sells any excess electricity to a public utility, would the transmission and distribution elements of these systems be fully or partially exempt?

9. **Public utilities not affected as the new construction exclusion is only applicable to locally assessed property.** Active solar energy systems owned by public utilities and subject to assessment by the Board are not exempt from property taxation; their value would continue to be captured under the unitary approach to value. Proposition 13's (Article XIII A) assessment rollback provisions, 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 do not apply to state-assessed property, only to locally assessed property.

COST ESTIMATE

The Board would incur some minor absorbable costs in informing and advising county assessors, public and staff of the new provisions of the new construction exclusion and designed the required claim form.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Current law excludes from classification of "newly constructed" the construction or addition of any active solar energy system, as specified. After a change in ownership, the entire property is subject to reassessment, and any exclusion for a solar energy system is lost. Consequently, in the case of properties constructed for immediate resale, there is limited, if any, tax benefit to a new construction exclusion.

Current law does not exclude transmission and distribution equipment used in the production of solar energy.

Residential Property. According to the California Construction Industry Research Board 2007 forecast, 170,000 new residential properties will be newly constructed this year. Staff estimates that homeowners will invest $30,000 or more on average to install an active solar energy system during construction of a new residence. Assuming 2.5% of all new residences in California were constructed with active solar energy systems this year, the initial assessed value loss can be computed as follows:

170,000 x $30,000 x 2.5% = $128 million

Assuming an average annual turnover rate of 12% for residential property, estimated assessed value loss through the 2015-16 fiscal year can be computed as follows:

Year	**Assessed Value Loss**		**Total**
2008-09	$128 million	=	$128 million
2009-10	$128 million + [$128 million x 88%]	=	$241 million
2010-11	$128 million + [$241 million x 88%]	=	$340 million
2011-12	$128 million + [$340 million x 88%]	=	$427 million
2012-13	$128 million + [$427 million x 88%]	=	$504 million
2013-14	$128 million + [$504 million x 88%]	=	$572 million
2014-15	$128 million + [$572 million x 88%]	=	$631 million
2015-16	$128 million + [$631 million x 88%]	=	$683 million
Total			$3.53 billion

Non-residential Property. According to the California Construction Industry Research Board, the 2007 forecast cost for all non-residential new construction is $14 billion. Unlike most residential property, non-residential property is generally built for the initial owner and not constructed for the purpose of immediate resale. Assuming that on average 1% of new non-residential construction is intended for immediate resale, and further assuming that on average the cost of a commercial solar energy system is around 10% of total building cost, we can estimate the initial assessed value loss as follows:

$14 billion x 1% x 10% = $14 million

Assuming an average annual turnover rate of 5% for non-residential property, estimated assessed value loss through the 2015-16 fiscal year can be computed as follows:

Year	**Assessed Value Loss**		**Total**
2008-09	$14 million	=	$14 million
2009-10	$14 million + [$14 million x 95%]	=	$27 million
2010-11	$14 million + [$27 million x 95%]	=	$40 million
2011-12	$14 million + [$40 million x 95%]	=	$52 million
2012-13	$14 million + [$52 million x 95%]	=	$63 million
2013-14	$14 million + [$63 million x 95%]	=	$74 million
2014-15	$14 million + [$74 million x 95%]	=	$84 million
2015-16	$14 million + [$84 million x 95%]	=	$94 million
Total			$448 million

Transmission and Distribution Equipment. Staff has been unable to identify commercial-scale solar generation facilities within the state. Therefore, initially we estimate that the revenue impact of this bill on the transmission and distribution equipment of these facilities to be minimal, increasing over time as the expansion of solar energy systems and the policies of the California Solar Initiative continue to be a major goal for California.

The revenue impact of this bill at the basic 1% property tax rate through fiscal year 2015-16 is:

Residential Property	$3.53 billion	x 1%	=	$35.3 million
Non-residential Property	$448 million	x 1%	=	$4.5 million

REVENUE SUMMARY

This bill would reduce property tax revenues at the basic 1% property tax rate by $1.4 million initially, and by $39.8 million through fiscal year 2015-16.

Year	Revenue Loss
2008-09	$ 1.4 million
2009-10	$ 2.7 million
2010-11	$ 3.8 million
2011-12	$ 4.8 million
2012-13	$ 5.7 million
2013-14	$ 6.5 million
2014-15	$ 7.1 million
2015-16	$ 7.8 million
Total	$39.8 million

Analysis prepared by:	Rose Marie Kinnee	(916) 445-6777	06/11/07
Revenue estimate by:	Chris Butler	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

ls 1451-2rk.doc