

Date of Hearing: July 27, 2020

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

Autumn R. Burke, Chairwoman

SB 364 (Mitchell) – As Amended July 27, 2020

2/3 vote. Tax levy. Fiscal committee.

SENATE VOTE: Not relevant

SUBJECT: Change in ownership: nonresidential active solar energy systems: initiative

SUMMARY: Changes the classification of nonresidential active solar energy systems from real property to personal property and creates a property tax exemption for systems constructed prior to January 1, 2025 if voters approve Proposition 15, an initiative constitutional amendment to require fair market value based property tax assessments for certain commercial and industrial real property. Specifically, **this bill:**

- 1) Changes the classification of a "nonresidential" active solar energy system from real property to personal property by statutorily redefining terms. Specifically:
 - a) Defines "personal property" as including a nonresidential active solar energy system; and,
 - b) Defines "improvements" as excluding a nonresidential active solar energy system.
- 2) Creates a personal property tax exemption for a nonresidential active solar energy system.
- 3) Makes the existing real property new construction exclusion for active solar energy systems inapplicable to a nonresidential active solar energy system.
- 4) Exempts a nonresidential active solar energy system constructed or installed prior to January 1, 2025, from property taxation as personal property, as specified.
- 5) Limits, with respect to a system constructed or installed prior to this bill's operative date, the above personal property exemption to a nonresidential active solar energy system that was receiving the new construction exclusion on this bill's operative date.
- 6) Allows the personal property exemption to continue until there is a subsequent change in ownership of the nonresidential active solar energy system.
- 7) Provides that a change in ownership of a nonresidential active solar energy system occurs if it would have met the parameters for a change in ownership applicable to real property had the system been considered real property instead of personal property.
- 8) Defines a "nonresidential active solar energy system" as a system that uses solar devices to provide for the collection, storage, or distribution of solar energy, and that is not constructed or installed in or on residential property.

- 9) Defines a "residential property" as real property used as residential property, including both single-family and multiunit structures, and the land on which those structures are constructed or placed.
- 10) Provides that the above provisions in this bill would become operative if voters approve Proposition 15, an initiative measure adding Section 2.5 to Article XIII A of the California Constitution at the November 3, 2020, statewide general election, which would require fair market value based property tax assessments for certain commercial and industrial real property
- 11) Provides that in the event Proposition 15 is not approved, provisions in this bill will remain inoperative and effectively repealed on January 1, 2021.
- 12) Makes a legislative finding and declaration that it is the intent of the Legislature, in enacting this chapter [Chapter 4.5], to ensure active solar energy systems that would have been exempt from taxation because of the new construction exclusion continue to be exempt from taxation until there is a subsequent change in ownership of the active solar energy system.
- 13) States the provisions of Chapter 4.5 are to be liberally construed so as to effectuate their intent, policy, and purposes.
- 14) Includes severability language that states that if any provision or its application is held invalid, that invalidity shall not affect other provisions or applications that can be given effect without the invalid provision or application.
- 15) Makes other conforming changes.

EXISTING LAW:

- 1) Provides that all property is taxable unless otherwise provided by the California Constitution or federal law. (Section 1 of Article XIII of the California Constitution.)
- 2) Authorizes the Legislature with a 2/3 vote to classify personal property for differential taxation or for exemption. (Section 2 of Article XIII of the California Constitution.)
- 3) Limits *ad valorem* taxes on real property to 1% of the full cash value of that property as set forth in the California Constitution based on the county assessor's determination of property value when purchased, newly constructed, or a change in ownership has occurred. This value, known as the "base year value," may reflect the yearly inflation rate, not to exceed 2% for any given year. In contrast, personal property is valued each year at its market value.
- 4) Requires the assessor to increase a property's assessment to reflect the full cash value of "new construction" when substantial additions or alterations occur. New construction is assigned its own distinct base year value, and the remainder of the property's base year value is unaffected.
- 5) Allows a new construction exclusion in the case of the construction or addition of an active solar energy system that is real property.
- 6) Provides the exclusion on the basis that the system is a real property.

- 7) Excludes the value added by the system from property taxation, until there is a subsequent change in ownership.
- 8) Sunsets the new construction exclusion for active solar energy systems on January 1, 2025.
- 9) Specifies that after the exclusion's sunset date, active solar energy systems that qualify for the new construction exclusion prior to January 1, 2025, continue to be excluded, until there is a subsequent change in ownership.

FISCAL EFFECT: The State Board of Equalization (BOE) states that the revenue impact of this bill is indeterminable.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

Since the 1980s, California voters and the Legislature have provided tax exemption to residential and commercial projects for solar energy projects to incentivize the state's transition to renewable energy and help reduce the upfront cost of solar energy system installation. Existing law provides exemption from taxation to nonresidential active solar energy systems constructed or installed prior to January 1, 2025 under the 'newly construction' exclusion, until there is subsequent change in ownership. Unfortunately, the Schools and Communities First (SCF) split-roll initiative, currently on the November 3rd ballot, removes this definition, inadvertently causing full value re-assessment of nonresidential solar energy systems that are exempt under current law.

SB 364 seeks to preemptively correct the unintended impact of the upcoming SCF split-roll initiative on nonresidential solar energy systems in the state. SB 364 ensures that nonresidential active solar energy systems in the state constructed or installed prior to January 1, 2025, as already provided in current law, continue to be exempted from taxation by reclassifying them as personal property. In the event the split-roll initiative passes, SB 364 will ensure preservation of the existing exemption as intended. If, however, the split-roll ballot initiative is not approved at the statewide general election, SB 364 becomes inoperative preserving the existing law exemption for nonresidential solar energy generation systems.

- 2) This bill is supported by Tenaska, Inc., which notes:

Since 1980, commercial and utility-scale solar projects have been partially excluded from annual property tax assessments per voter-approved Proposition 7. Proposition 15 on the November 2020 ballot would inadvertently repeal the solar tax exclusion, making utility-scale and commercial solar systems taxable at their full fair market value as of January 1, 2022.

Current tax treatment for these solar projects has aided California's transition to renewable energy by lowering projects' costs to ratepayers. The tax exclusion is passed through to ratepayers in direct cost savings. Should Proposition 15 pass without this fix, existing solar projects and contracts will face potential default, and projects with signed contracts that haven't been built will be delayed, forestalling much needed new job

creation, creating additional ratepayer burdens, and delaying progress toward our clean energy and climate goals at the worst possible time.

SB 364 ensures that the existing tax treatment for larger solar projects remains intact and clarifies that projects that have already changed ownership and are paying property taxes cannot be "re-exempted" under the new law. Importantly, the language in SB 364 is tied to passage of Proposition 13 – if voters approve the measure, the SB 364 language goes into effect. If the measure is not approved SB 364's language does not go into effect, effectively leaving status quo in place, which is the goal of the legislation.

Passage of SB 364 is crucial to maintaining both progress toward our climate goals and investor confidence in California's electricity market.

- 3) This bill is opposed by the California Assessors' Association (CAA), in part, on the basis that this bill is unconstitutional. The CAA states:

Active solar systems have always been considered by assessors, the Board of Equalization and the Legislature to be real property subject to the property tax imposed by the state constitution. After the passage of Proposition 13 in 1978, the Legislature passed SCA 28 (Proposition 7 of 1980) to allow a limited exclusion from the term "new construction" for "active solar systems" added by homeowners and businesses. The ballot materials clearly identified such systems as "real property"; indeed, there would have been no need to amend the constitution had such systems not been improvements to real property. [...]

It is well settled that the Constitution imposes the property tax on real property and the Legislature has no authority to exempt *real* property from taxation. At the same time, the Constitution allows the Legislature, with a 2/3's vote of both houses, to exempt *personal* property from property taxes. The courts have closely guarded against the legislative temptation to evade the prohibition against exemptions from the property tax by reclassifying "real property" as something else.

- 4) Committee Staff Comments:

- a) *California's Constitution allows the addition of an active solar energy system to a property to be "excluded" from property tax assessment on the basis that it is real property:* When a substantial addition to real property occurs, the law requires the assessor to increase the assessment to reflect the value of the "newly constructed" property. However, California's Constitution provides certain new construction exclusions. Any value added by additions where a new construction exclusion is available is not subject to property tax until there is a subsequent change in ownership of the property.

In 1980, Proposition 7 (SCA 28) amended the Constitution to create a new construction exclusion for the construction or addition of an active solar energy system. For the last 40 years, these active solar energy systems have been classified and treated as real property. The solar exclusion applies to both residential and nonresidential systems equally and applies to a wide range of systems from a utility-scale solar project to a rooftop installation on a home.

- b) *Proposition 15, the "split roll" initiative to require fair market value based assessments of commercial and industrial real property, will be before California voters at the November 3, 2020 general election:* California has an acquisition value based property taxation system for real property. Existing law generally limits a property's assessed value to its market value when first acquired with a maximum annual 2% inflation adjustment thereafter plus an addition for any new construction that subsequently occurs. If approved by voters, Proposition 15 [Initiative 1870 (19-0008A1)], would transition the assessment of certain commercial and industrial real property to a fair market value standard. Proposition 15 is commonly described as creating a "split roll" since it establishes a different value standard for commercial and industrial property than for residential property. Residential property would retain existing law's acquisition value based standard and is not impacted by Proposition 15. After the initial reassessment of commercial and industrial property to fair market value, which is phased in with a start date of January 1, 2022, Proposition 15 requires periodic reassessments at least every three years thereafter. Proposition 15 is estimated to increase annual property tax revenues by \$7.5 billion to \$12 billion.
- c) *The property tax incentive for the installation of an active solar energy system is in the form of an exclusion, it is not an exemption:* If voters approve Proposition 15, then an active solar energy system currently excluded from assessment under the new construction exclusion that is located on a commercial and industrial property would effectively become subject to property tax. This is because an "exclusion" from property tax is not the same thing as an "exemption" from property tax. Generally, for commercial and industrial property that transition to a fair market value standard, the new construction and change in ownership provisions that limit when real property values are increased (for new construction) or reset to fair market value (for a change in ownership) would no longer apply. Consequently, the solar new construction exclusion no longer applies and the active solar energy system would become subject to property tax as the entire property, including the solar system, would be valued at its fair market value.
- d) *California's Constitution allows the Legislature to exempt personal property from property taxation:* Section 2 of Article XIII of the California Constitution authorizes the Legislature, with a 2/3 vote, to classify personal property for differential taxation or for exemption. This bill seeks to use this provision of the Constitution to classify nonresidential active solar energy systems as personal property and create a property tax exemption on this basis. This bill is keyed with a 2/3 vote consistent with the Constitution's requirement.
- e) *What is the problem?* If Proposition 15 passes, then solar systems currently excluded from property tax would become taxable at fair market value. This applies to both active solar energy systems installed at a business or industrial property and major freestanding solar energy facilities selling renewable energy to utilities. Solar industry organizations state that the resulting unexpected tax increase would jeopardize the financial viability of existing solar projects and make certain planned solar projects economically unviable and un-financeable, which would, in turn, impact state clean energy and climate goals. A published Fact Sheet by the Solar Energy Industries Association states:

This [initiative] will jeopardize the equity interests in existing solar power plants.

These plants sell their power under long-term power purchase agreements (PPAs), the

pricing of which was contractually agreed to on the basis that property taxes would not be imposed. Existing power plants simply cannot absorb this added cost based on their fixed PPAs.

It will similarly jeopardize yet-to-be-built solar power plants, particularly those for which PPAs have already been entered into. The PPA price does not reflect the materially increased property tax cost. Such projects will not be able to get adequate financing and may have to be abandoned. Future solar projects would have to build the cost of the property tax into their PPA bids, increasing the cost of energy to California's consumers.

- f) *What does this bill do?* To preserve the tax benefits currently bestowed on active solar energy systems via the new construction exclusion if Proposition 15 passes, this bill seeks to preemptively reclassify nonresidential active solar energy systems from real property to personal property and create a property tax exemption for this property. The personal property tax exemption would apply to systems constructed or installed before January 1, 2025, and allows the exemption to continue to apply on and after this date, until there is a subsequent change in ownership of the system. However, systems constructed or installed before Proposition 15's operative date, would be eligible for this exemption only if that system was excluded from assessment on Proposition 15's operative date.

Residential active solar energy systems would continue to be classified as real property and remain eligible for the new construction exclusion, while nonresidential active solar energy systems would become ineligible for the new construction exclusion. This bill also provides that if voters do not approve Proposition 15, then its provisions are inoperative and will be effectively repealed on January 1, 2021.

Together, these provisions serve to transition a pre-existing property tax incentive from an "exclusion" to an "exemption" to maintain the status quo for nonresidential active solar energy systems and continue to encourage and to provide incentives for the development of solar energy.

- g) *Setting a precedent:* If Proposition 15 is approved, other commercial and industrial property owners will also incur unanticipated property tax increases. This bill could set a precedent of redefining specific items of real property improvements as personal property and creating an exemption to minimize the impact of fair market value based assessments that other commercial and industrial property owners adversely impacted by the initiative would similarly seek.
- h) *Related legislation:* AB 105 (Ting) includes similar provisions to classify and exempt nonresidential active solar energy systems from property tax as personal property if Proposition 15 passes. These provisions were amended into AB 105 in the Senate on June 22, 2020, and passed the Senate on June 25, 2020. Because the Senate amendments deleted the version of AB 105 passed by the Assembly, AB 105 was referred to this Committee pursuant to Rule 77.2. Subsequently, AB 105's provisions were amended into this bill with a modification to address an unintended consequence of exempting currently taxable systems consistent with this bill's intent to ensure the continued property tax benefit provided to a particular system should Proposition 15 be approved. In the case of a pre-existing active solar energy system, this bill requires the system to be receiving the benefit of the new construction exclusion on the day that Proposition 15

becomes operative. Additionally, this bill makes related findings and declarations which AB 105 lacked.

REGISTERED SUPPORT / OPPOSITION:

Support

American Wind Energy Association*
 Berkshire Hathaway Energy
 BHE Renewables
 California Calls
 California Community Choice Association*
 California League of Conservation Voters
 California Solar & Storage Association
 Capital Dynamics, Inc.*
 Clearway Energy Group
 Coalition for Clean Air*
 De Shaw Renewable Investments*
 EDF Renewables*
 Evolve California
 First Solar, Inc.*
 Idemitsu Renewables*
 Independent Energy Producers Association
 Large-scale Solar Association
 League of Women Voters of California
 National Electrical Contractors Association*
 Natural Resources Defense Council*
 RWE Renewables Americas, LLC*
 Recurrent Energy, LLC*
 SEIU California
 Spower*
 Silicon Valley Clean Energy
 Solar Energy Industries Association
 State Building & Construction Trades Council of California*
 Sunpower Corporation*
 Tenaska
 Union of Concerned Scientists*
 Vote Solar*

*Support letter submitted for AB 105 (Ting)

Opposition

California Assessors' Association
 California Business Roundtable