Date of Hearing: May 2, 2022

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Jacqui Irwin, Chair

AB 2887 (Eduardo Garcia) – As Amended March 24, 2022

FOR TESTIMONY ONLY

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Public resources: Sales and Use Tax Law: exclusions

SUMMARY: Increases, from $100 million to $150 million, the limit on annual sales and use tax (SUT) exclusions under the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) Act (Act). Specifically, **this bill**:

1) Provides that, for purposes of complying with Revenue and Taxation Code (R&TC) Section 41, the Legislature finds and declares the following:

    a) The purpose of expanding the SUT exclusion is to further incentivize California-based manufacturing, California-based jobs, advanced manufacturing, reduction of greenhouse gases, or reduction in air and water pollution or energy consumption;

    b) The performance indicators for the Legislature to use in determining whether this exclusion is achieving its stated purpose shall be the number of businesses receiving exclusions, and total value of exclusions granted;

    c) No later than January 10, 2023, and each January 10 thereafter, the CAEATFA shall submit a report to the Legislature in compliance with Government Code Section 9795 detailing the following:

        i) The number of businesses receiving exclusions from SUT; and,

        ii) The total dollar value of exclusions allocated.

2) Provides that, notwithstanding existing law, no appropriation is made by this bill and the state shall not reimburse any local agency for any lost SUT revenues.

3) Takes immediate effect as a tax levy.

EXISTING LAW:

1) Imposes, under the SUT Law, a tax on retailers measured by the gross receipts from the sale of tangible personal property (TPP) sold at retail in this state or on the storage, use, or other consumption in this state of TPP purchased from a retailer for storage, use, or other consumption in this state.

2) Establishes the CAEATFA under the Act. The Act authorizes, until January 1, 2026, the authority to provide financial assistance to a participating party in the form of specified SUT exclusions for projects, including those that promote the following:

   a) California-based manufacturing;

   b) California-based jobs;

   c) Advanced manufacturing;

   d) Reduction of greenhouse gases; or,

   e) Reduction in air and water pollution or energy consumption.

3) Prohibits the SUT exclusions under the Act from exceeding $100 million for each calendar year.

4) Requires any bill authorizing a new tax expenditure to contain, among other things, specified goals, purposes, and objectives the tax expenditure will achieve, detailed performance indicators, and data collection requirements.

FISCAL EFFECT: Unknown

COMMENTS:

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

> The world demand for Lithium is expected to grow as much as ten-fold in the next decade, but virtually none is produced in the United States; instead, almost all of the global supply today is mined in Argentina, Chile, China and Australia. The existing Salton Sea geothermal plants are well positioned to become a competitive source of supply that could satisfy more than one-third of today's worldwide lithium demand. The opportunity for Lithium production in California has the potential to unleash billions of dollars of new economic infrastructure development in our state. AB 2887 complements the Governor's critical efforts in building out a world-class battery manufacturing ecosystem in tandem with Lithium production and processing right here in California.

2) This bill is supported by EnergySource Minerals, LLC, which notes the following:

> The transportation sector is responsible for 41% of California's greenhouse gas emissions. Electric vehicles and battery storage connected to renewable electric generation are poised to change this. California has the potential to be a global leader in producing sustainable Lithium, the key ingredient in those batteries, by extracting Lithium from brine that is brought to the surface for geothermal energy production near the Salton Sea in Imperial County.
>
> As with all minerals and commodities, price will remain the driving factor of where Lithium is sourced by major buyers. China, Australia and Chile have long been the dominant global players, and policy should promote U.S. competitiveness. Along with traditional lithium production, sustainable lithium brine resources like the Salton Sea exist elsewhere globally, and we should not take CA's resource for granted. Even other

states have viable Lithium brine resources. Emerging producers are already contributing substantially to the Imperial County economy and are poised to do even more, as long as they remain potentially competitive. In order to support this new sector of California-based jobs and industry, policy makers should ensure that investment remains here rather than move to other states with more favorable regulatory and taxation environments.

3) Committee Staff Comments:

a) *California's eroding SUT base*: The SUT represents the state's second largest source of General Fund (GF) revenues. Nevertheless, the past 70 years have seen a dramatic reduction in the state's reliance on the SUT and a corresponding increase in its reliance on personal income tax revenues. In Fiscal Year (FY) 2022-23, SUT revenues are estimated to comprise only 16.3% of the state's GF revenues, down from nearly 60% in FY 1950-51.

The SUT Law was enacted in a very different era. In the 1930s, California's economy was largely dominated by manufacturing, and residents mostly bought and sold tangible goods. Thus, in establishing the base for a new consumption tax, it made sense to impose the tax on sales of TPP, defined as personal property that may be "seen, weighed, measured, felt, or touched." Over the past 80 years, however, California's economy has seen dramatic growth in the service and information sectors, resulting in a significant erosion of the SUT base. For example, the Commission on the 21st Century Economy noted that spending on taxable goods represented 34.6% of personal income in 2008, down from 55.4% in 1980. As a result, tax experts and economists from across the political spectrum argue that California should expand its SUT base.

It could be argued that, while well-intentioned, additional SUT exemptions and exclusions further erode an already shrinking SUT base. This, in turn, increases fiscal pressures to maintain or even increase California's relatively high SUT rate. High rates arguably promote non-compliance and encourage out-of-state purchases, placing California retailers at a competitive disadvantage. High rates also risk impacting consumer decision-making, which runs counter to widely accepted principles of sound tax policy.

b) *What does this bill do*? This bill would increase, from $100 million to $150 million, the limit on annual SUT exclusions under the Act.

c) *Overview of the CAEATFA exclusion program*: The CAEATFA, or the "authority", is a governmental body comprised of the following five individuals:

i) The Director of Finance;

ii) The Chairperson of the State Energy Resources Conservation and Development Commission;

iii) The President of the Public Utilities Commission;

iv) The State Controller; and,

v) The State Treasurer, who serves as the chairperson of the authority.

Among other things, the authority is charged with promoting the creation of California-based manufacturing, California-based jobs, advanced manufacturing, the reduction of greenhouse gases, and reductions in air and water pollution or energy consumption. To further these purposes, the authority may approve a project, as defined, for financial assistance in the form of the SUT exclusion established in R&TC Section 6010.8. The authority must evaluate project applications based on all of the following criteria:

i) The extent to which the project develops manufacturing facilities, or purchases equipment for manufacturing facilities, located in California;

ii) The extent to which the anticipated benefit to the state from the project equals or exceeds the projected benefit to the participating party from the SUT exclusion;

iii) The extent to which the project will create new, or result in the loss of, permanent, full-time jobs in California, including the average and minimum wage for each classification of full-time employees proposed to be hired or not retained;

iv) To the extent feasible, the extent to which the project, or the product produced by the project, results in a reduction of greenhouse gases, a reduction in air or water pollution, an increase in energy efficiency, or a reduction in energy consumption, beyond what is required by federal or state law or regulation;

v) The extent of unemployment in the area in which the project is proposed to be located; and,

vi) Any other factors the authority deems appropriate in accordance with the Act.

The SUT exclusions granted for approved projects may not exceed $100 million per calendar year.

d) *Lithium Valley Development*: The Governor's Budget Summary for FY 2022-23 notes that lithium is becoming an increasingly critical resource as California moves toward a clean energy future to combat the climate crisis. Specifically, lithium is a crucial component of batteries needed to power electric vehicles. California has rich but untapped lithium reserves, including those in geothermal brine more than a mile underground near the Salton Sea. Experts estimate that the region could satisfy more than one-third of today's global lithium demand. As such, the Administration has proposed a robust program that will provide incentives to advance the clean energy market in California. Details of such a program, however, are still forthcoming.

e) *This bill's goals*: This bill is clearly motivated by a desire to encourage the exploration and extraction of lithium deposits in California. At the same time, however, this bill never makes mention of lithium or any related extraction activities. This bill simply expands, by $50 million annually, the amount of SUT exclusions that the authority may grant to projects, without earmarking any of these additional funds for a particular purpose. The author's office has noted, however, that the authority has developed a list of Emerging Strategic Industries that includes activities associated with the development, exploration, and production of lithium within California's Lithium Valley. As such, such projects are potentially eligible for additional points in the authority's application scoring process.

f) *The Legislative Analyst's Office weighs in*: In December 2018, the Legislative Analyst's Office (LAO) released a detailed evaluation of the CAEATFA sales tax exclusion. This report noted, among many other things, that the state currently administers two overlapping SUT exemption programs – namely, the one administered by the authority, and the partial exemption for manufacturing and research and development activities. The LAO noted that the partial manufacturing exemption is broader than the CAEATFA exemption and easier for businesses to use. As such, the LAO recommended allowing the CAEATFA exclusion to expire. Specifically, the report noted:

> We do not see a need for the state to administer both the CAEATFA exemption and the partial exemption. Of the two programs, the CAEATFA exemption is narrower and harder for businesses to use. Consequently, we recommend that the Legislature allow the CAEATFA exemption to expire as scheduled under current law. To the extent that some CAEATFA participants would not be eligible for the partial exemption, the Legislature could expand the partial exemption to include them.

g) *Committee's tax expenditure policy*: SB 1335 (Leno), Chapter 845, Statutes of 2014, added R&TC Section 41, which recognized that the Legislature should apply the same level of review used for government spending programs to tax credits introduced on or after January 1, 2015. AB 263 (Burke), Chapter 743, Statutes of 2019, extended the requirements in R&TC Section 41 to all tax expenditure measures under the Personal Income Tax Law, the Corporation Tax Law, and the SUT Law introduced on or after January 1, 2020. This Committee has also adopted a policy, requiring that all tax expenditure proposals must comply with the requirements of R&TC Section 41. A tax expenditure proposal must outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements. This bill, as currently drafted, complies with R&TC Section 41.

   In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to the policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means 10 years. Committee staff recommends amending this bill to clarify that the augmented exclusion amount shall apply for no more than five years.

REGISTERED SUPPORT / OPPOSITION:

Support

Clean Power Campaign
EnergySource Minerals, LLC
Sanitation Districts of Los Angeles County

State Treasurer Fiona Ma

Opposition

None on file

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