
SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Anna M. Caballero, Chair

2021 - 2022 Regular

Bill No: AB 2887
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Consultant: Grinnell

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Tax Levy: Yes
Fiscal: Yes

PUBLIC RESOURCES: SALES AND USE TAX LAW: EXCLUSIONS

Increases the current authorization for the California Alternative Energy and Advanced Transportation Authority to allocate sales and use tax exclusions from \$100 million to \$150 million.

Background

Sales and Use Tax. State law imposes the sales tax on every retailer “engaged in business in this state” that sells tangible personal property, and requires them to register with the California Department of Tax and Fee Administration (CDTFA), as well as collect appropriate tax at purchase and remit the amount to CDTFA. Sales tax applies whenever a retail sale occurs, which is generally any sale other than one for resale in the regular course of business. The current rate is 7.25% as shown in the table below. Additionally, cities, counties, and specified special districts may increase the sales and use tax, also known as district or transactions and use taxes.

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes
1.0625%	Local Revenue Fund (2011 Realignment)	Local governments to fund local public safety services
0.50%	State (1991 Realignment)	Local governments to fund health and welfare programs
0.50%	State (Proposition 172 - 1993)	Local governments to fund public safety services
1.25%	Local (City/County) 1.00% City and County 0.25% County	City and county general operations. Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

Unless the purchaser pays the sales tax to the retailer, he or she is liable for the use tax, which the law imposes on any person consuming tangible personal property in the state. The use tax is the same rate as the sales tax, and also like the sales tax, must be remitted on or before the last day of the month following the quarterly period in which the person made the purchase.

State Sales and Use Tax Exemption for Manufacturing Equipment. In 2013, the Legislature enacted AB 93 (Committee on Budget) and SB 90 (Committee on Budget and Fiscal Review), measures which reformed California's economic development policies by eliminating enterprise zones and other geographically-targeted economic development areas, instead allowing three new tax benefits:

- The New Employment Credit, where the Franchise Tax Board allocates credits for wages paid by taxpayers to qualified employees within former enterprise zones, and other areas that suffer from high levels of poverty and unemployment. The credit lasts from the 2014 taxable year until the 2019 taxable year. The Legislature extended the credit in 2018 until 2026 (SB 855, Committee on Budget and Fiscal Review).
- The California Competes Tax Credit, where the California Competes Tax Credit Committee, also created by the bill, can award various tax credits up to an annually capped amount to taxpayers who apply. The Committee is comprised of the Treasurer, the Director of Finance, the Director of the Governor's Office of Business and Economic Development (GO-BIZ), one appointee of the Speaker of the Assembly, and one appointee from the Senate Committee on Rules. SB 855 also extended the authority for the Committee to allocate credits through the 2022-23 fiscal year, and the credit itself through the 2029 taxable year.
- A state-only (3.9375%) sales and use tax exemption on purchases of manufacturing equipment made by taxpayers within specific North American Industrial Classification System codes, capped at \$200 million annually per taxpayer, effective July 1, 2014, and ending July 1, 2022. In 2017, the Legislature expanded and extended this exemption, as part of an agreement to extend the Global Warming Solutions Act (AB 398, E. Garcia, 2018). AB 398 also required the Greenhouse Gas Reduction Fund to compensate the General Fund for the total dollar amount of exemptions

CAEATFA. Housed in the office of the State Treasurer, the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) provides financing through conduit or revenue bonds, loan guarantees, loan loss reserves, and a sales and use tax exemption for facilities that use alternative energy sources and technologies or engage in advanced manufacturing. CAEATFA's board, composed of the Treasurer, Controller, Director of Finance, Chair of the Energy Commission, and President of the Public Utilities Commission, decides which projects to assist.

When the Legislature created CAEATFA in 1980, it provided that its purchases of tangible personal property were *excluded* from both the state and local shares of the sales and use tax, meaning that the sales and use did not apply at all to its purchases. However, CAEATFA was basically inactive until 2008, when Governor Arnold Schwarzenegger and State Treasurer Bill Lockyer announced that CAEATFA would use its sales tax exclusion authority to purchase \$26 million in equipment on behalf of Tesla Motors, and convey it to them sales and use tax-free. Subsequently, the Legislature directed CAEATFA to administer a sales and use tax exclusion program for manufacturers of alternative source technology used for renewable electricity generation or advanced transportation under a statutory framework until January 1, 2021 (SB 71, Padilla, 2010). The Legislature subsequently extended the program to:

- Advanced manufacturing, until July 1, 2016 (SB 1128, Padilla, 2012), which the Legislature subsequently extended until January 1, 2021 (AB 1269, Dabaneh, 2015); and

- Property where at least 50% of its use is to process recycled feedstock intended to be reused in the production of another project, or using recycled feedstock in the production of another product or soil amendment, until January 1, 2021 (AB 199, Eggman, 2015).

The Legislature last extended the CAEATFA program until January 1, 2026 (AB 176, Cervantes), 2019. Through December 31, 2021, CAEATFA approved a total of 278 project applications, of which 85 are active, 135 are complete, and 58 did not move forward. Alternative Source projects have received the most awards, but CAEATFA has allocated higher amounts to Advanced Manufacturing and Advanced Transportation due to the high capital intensity of these types of projects.

The CAEATFA Board approves all applications in public meetings held monthly. After the Board approves an application, the applicant then purchases equipment using a certificate issued by CDTFA, and subsequently reports quarterly regarding their use of the exemption, and annually regarding its business activities. Applicants must purchase at least 15% of the equipment proposed in its application within 18 months, or risk CAEATFA terminating its application.

CAEATFA can allocate exemptions up to \$100 million annually to successful applicants under all three programs; however, CAEATFA can only allocate exemptions to projects where it finds that the benefit to the state exceeds the benefit to the applicant. The extent to which the project develops manufacturing facilities, or purchases equipment for manufacturing facilities, located in California. State law sets forth the following criteria for CAEATFA to evaluate applications:

- The extent to which the project will create new, permanent jobs in California.
- 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.
- The extent of unemployment in the area in which the project is proposed to be located.
- Any other factors the authority deems appropriate.

Last year, CAEATFA implemented regulations that set aside \$20 million for small-projects, and \$15 million for larger ones, among other changes. Under these regulations, the Authority approved 31 projects in 2021. Tesla Motors, which has received almost \$200 million in exclusions under the program, withdrew its application for an additional \$10 million earlier this year. Additionally, CAEATFA issued a list of Emerging Strategic Industries in November, 2021, to include lithium compounds, geothermal steam, and lithium batteries. The designation means that applications for projects within the industry earn bonus points, effective in 2022.

CAEATFA has awarded the full amount under the \$100 million cap each year since 2015, largely due to both growing the number of projects assisted, as well as a few large projects. The Legislative Analyst's Office (LAO) states that the cap has become more binding over time, noting "before 2019, exclusions were available for most of the year. In 2019, awards hit the cap in July. In 2020 and 2021, the program already had received applications for more than \$100 million by the first application deadline—before the calendar year had even begun."

The author wants to increase the current cap to \$150 million to spur additional manufacturing of alternative source products, especially the development of lithium extraction near the Salton Sea.

Proposed Law

Assembly Bill 2887 increases the current authorization for CAEATFA to allocate sales and use tax exclusions from \$100 million to \$150 million. The bill also makes a conforming change, and includes findings and declarations to comply with Section 41 of the Revenue and Taxation Code.

State Revenue Impact

According to CDTFA, AB 2887 results in an additional estimated sales and use tax loss of \$50 million per year for three years.

Comments

1. Purpose of the bill. According to the author, “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. Assessing performance. Evaluating the success or failure of tax expenditure programs can be difficult, so in recent years, the Legislature has directed the LAO to report regarding any newly enacted or extended programs to help inform whether it should be renewed, modified, or allowed to expire. To fulfil this direction for the CAEATFA sales and use tax exclusion program, LAO published “Evaluation of Sales Tax Exemption for Certain Manufacturers,” in December 2018, which recommends the Legislature allow the program to expire. LAO grounds its recommendation on the program’s overlap with the state’s general exemption, and adds that the program’s application process is not worthwhile because it is narrow and hard to use. However, LAO notes that if streamlined, the program could be transferred to CDTFA. CAEATFA responds by asserting that its rigorous evaluation demonstrates environmental and economic benefits that exceed foregone revenue resulting from the program, and its application process must be thorough to ensure it only approves applications that provide net benefits to the state. AB 2887 does not extend the sunset date of the CAEATFA program; instead, it would allow it to grant an additional \$50 million in each of the next three years before the program is current set to expire. However, the Committee may wish to consider whether increasing the authorization amount for the program is merited when LAO has advised it should be allowed to expire.

3. Revenue loss. Because SB 93 and AB 90’s state-only sales and use tax exemption apply to almost all of CAEATFA’s applicants, almost all of the foregone revenue resulting from increasing the authorization amount accrue to local agencies. Additionally, it’s unclear whether the revenue foregone is sales tax, which would be allocated to the jurisdiction where the equipment is purchased or shipped from, or use tax, which would flow to the countywide pool in the county where the equipment is used, so it’s hard to tell which local agencies are affected.

4. Something different. Several of the state’s tax expenditures for business activity allow any individual or businesses to qualify for the tax benefit by virtue of incurring specific costs, such as research and development or hiring specific individuals. Others direct a state agency, such as the

California Film Commission or the California Competes Tax Credit Committee, to accept applications from taxpayers seeking the benefit, and to allocate it according to criteria set in statute. CAEATFA follows the latter model, but with one important difference: to receive the tax benefit, the applicant must pass the “net benefits test,” based on statutory direction for CAEATFA to evaluate “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 sales and use tax exclusion.” To implement this direction, CAEATFA contracted with Blue Sky Consulting, who constructed a model that assesses an application’s environmental and economic benefits against the foregone revenue from the sales and use tax exclusion. The net benefits test assumes that the applicant purchases more equipment because of the exclusion than they otherwise would have, and assesses whether the incremental economic activity, tax revenue, and environmental effects resulting from the exclusion exceeds its foregone revenue. Only applications that pass the test advance to the CAEATFA board for consideration, and CAEATFA publishes each application in detail before its meetings.

5. Elemental. California is home to some of the world’s most abundant geothermal energy resources. The Salton Sea presents a unique opportunity to extract lithium from the brine that is already being produced by geothermal power plants around the Salton Sea. According to some estimates, the Salton Sea is capable of producing 600 kilotons of lithium per year and those resources could be extracted in a more environmentally-friendly manner than in other lithium-producing countries. Lithium production can help promote these goals by providing a critical component for the production of zero emission vehicles and energy storage for California’s electric grid. In 2020, the Legislature enacted AB 1657 (E. Garcia), which directed the California Energy Commission to establish and convene the Blue Ribbon Commission on Lithium Extraction in California, to review, investigate, and analyze certain issues and potential incentives, regarding lithium extraction and use in California. While the Commission is due to report later this year, a draft of preliminary recommendations identify the CAEATFA sales and use tax exclusion program, among other measures. While CAEATFA’s Emerging Strategic Industries designation awards additional points from applicants engaged in specified lithium business activities, these projects must compete against other applicants regardless of the amount of exclusions CAEATFA can authorize unless the Legislature creates a statutory set-aside as proposed by the Governor noted below. Additionally, hydrogen fueling and refueling infrastructure projects can help accomplish the state’s energy and climate goals too. The Committee may wish to consider amending AB 2887 to create set-asides under the bill’s expanded authorization for lithium, and hydrogen fueling, and make conforming changes.

6. Substitution? One risk of subsidizing equipment purchases is that firms will substitute machines for workers, especially as equipment becomes more efficient. While more equipment likely means more economic activity, it’s unclear whether the benefits of added productivity and economic activity resulting from the program accrue to workers in the form of higher wages or increased employment.

7. Related legislation. In his proposed 2021-22 Budget, Governor Newsom proposed raising the 2021 aggregate cap on awarded exclusions from \$100 million to \$200 million on a one-time basis. The Legislature did not enact the proposal. In his revised 2022-23 Budget, the Governor proposed to increase the cap by \$15 million from 2022-23 through 2024-25, and dedicate the incremental increase equipment purchases related to the extraction or processing of lithium, as well as equipment purchases related to manufacturing with lithium, among other changes.

Additionally, the Committee will consider AB 1951 (Grayson) at its June 29th hearing, which would convert the current General Fund-only sales and use tax exemption for manufacturing equipment into a full exemption. Almost any successful applicant under the CAEATFA program already has the full amount of the sales tax excluded from its qualified purchases. It's unclear whether firms will have any reason to apply to CAEATFA for an exclusion if AB 1951 is enacted, as they would no longer need to complete the steps necessary to obtain an exclusion.

8. Section 41. Section 41 of the Revenue and Taxation Code requires any bill enacting a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve, detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). AB 2887 states as its goal, purpose, and objective 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. The measure then directs CAEATFA to annually report on the number and dollar value of exclusions under the program.

Assembly Actions

Assembly Revenue and Taxation Committee:	11-0
Assembly Appropriations Committee:	16-0
Assembly Floor:	76-0

Support and Opposition (6/27/22)

Support: Arrival Automotive Usa, INC.
 Republic Services - Western Region

Opposition: League of California Cities

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