
SENATE COMMITTEE ON APPROPRIATIONS

Senator Anthony Portantino, Chair
2021 - 2022 Regular Session

AB 2887 (Eduardo Garcia) - Public resources: Sales and Use Tax Law: exclusions

Version: May 9, 2022

Urgency: No

Hearing Date: August 1, 2022

Policy Vote: GOV. & F. 5 - 0

Mandate: No

Consultant: Robert Ingenito

Bill Summary: AB 2887 would, until January 1, 2026, increase the current authorization for the California Alternative Energy and Advanced Transportation Authority (CAEATFA) to allocate sales and use tax exclusions, from \$100 million to \$150 million.

Fiscal Impact: This bill would result in an annual sales and use tax revenue loss of up to \$50 million for three years, 2023 through 2025. Of this amount, the General Fund revenue loss would be up to \$23 million per year, while the remainder would represent a reduction in local sales and use tax revenue. However, under the Constitution, the General Fund is required to offset a portion of the reduced local sales and use tax revenue. Specifically, the General Fund would have to backfill the 2011 Local Revenue Fund in the amount of up to \$6.2 million annually (See Staff Comments).

Note that the above amounts can be considered to be upper bounds. The actual annual revenue loss would likely be lower, a result of (1) timing differences between when project applications are approved and when their sales tax exclusions occur, and (2) the fact that some projects approved for an exclusion may not move forward.

Finally, CAEATFA anticipates costs of \$250,000 per year to review and process additional applications, ensure compliance, and report program information to the Legislature. These costs would largely be offset by increased application fees.

Background: Except where a specific exemption or exclusion is provided, current law imposes sales and use tax (SUT) on all retailers for the privilege of selling tangible personal property (TPP) at retail in California, or on the storage, use, or other consumption in this state of TPP purchased from a retailer. Unless purchasers pay the sales tax to the retailer, they are 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.

After the California Department of Tax and Fee Administration (CDTFA) collects SUT revenue (\$66 billion in 2020-21), it allocates the money to various state and local funds. Roughly half—collected from an approximately 3.9 percent rate—goes to the General Fund and can be spent on any state program, such as education, health care, and criminal justice. Another 1.25 percent, known as the Bradley-Burns rate, goes to cities and counties for general purposes. Three sales tax funds have uniform state rates and support specified programs—an approximately 1.1 percent rate for 2011 realignment (county-administered criminal justice, mental health, and social service programs); a 0.5

percent rate for 1991 realignment (county-administered health and social services programs); and a 0.5 percent rate for city and county public safety programs pursuant to Proposition 172 (1993). Additionally, some local governments levy optional local rates—known as Transactions and Use Taxes (TUTs)—and a small portion of these funds are used for general purposes. As of October 1, 2021, the average statewide SUT rate was 8.57 percent.

In 2013, the Legislature reformed the State’s economic development policies by eliminating enterprise zones and other geographically-targeted economic development areas, instead allowing three new tax benefits. One of those benefits was a state-only (3.9375 percent) SUT 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).

CAEATFA provides financing through many avenues, including a SUT exemption for facilities that use alternative energy sources and technologies or engage in advanced manufacturing. When the Legislature created the Authority in 1980, it provided that its purchases of TPP were excluded from both the state and local shares of the SUT, meaning that the SUT did not apply at all to its purchases. However, CAEATFA was basically inactive until 2008, at which time it was deemed to 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 SUT exclusion program for manufacturers of alternative source technology used for renewable electricity generation or advanced transportation until January 1, 2021 (SB 71, Padilla, 2010). The Legislature subsequently extended and expanded the program, such that it currently runs through January 1, 2026. 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.

The CAEATFA Board approves all applications in public meetings held monthly. The Authority can allocate exemptions up to \$100 million annually to successful applicants; however, it can only allocate exemptions to projects where it finds that the benefit to the State exceeds the benefit to the applicant. 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. 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.”

Proposed Law: This bill would increase the current authorization for CAEATFA to allocate SUT exclusions from \$100 million to \$150 million.

Related Legislation: AB 1951 (Grayson) would expand the Manufacturing Research and Development SUT exemption by making the expenditure a full exemption and removing the \$200 million cap on qualifying purchases per individual purchaser. The bill is currently pending in this Committee.

Staff Comments: As noted above, this Committee will also be considering AB 1951 (Grayson) in August. This bill would convert the current General Fund-only SUT exemption for manufacturing equipment into a full state and local exemption. Successful applicant under the CAEATFA program generally already have the full amount of the sales tax excluded from its qualified purchases. Thus, it is not clear whether firms would have any incentive to apply to CAEATFA for an exclusion if AB 1951 is enacted, as they would no longer need to complete the requisite steps to obtain an exclusion.

Also as discussed above, Proposition 30 (2012) protected the 2011 Local Revenue Fund by requiring any sales tax exemption that affects it to be backfilled by the General Fund. Thus, assuming an annual sales and use tax reduction of \$50 million from the bill, the fiscal impact to the State would be \$29.2 million, as follows: (1) a reduction in sales and use tax revenue to the General Fund of \$23 million, and (2) a General Fund backfill to the 2011 Local Revenue Fund of \$6.2 million.

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