
THIRD READING

Bill No: AB 2887
Author: Eduardo Garcia (D)
Amended: 5/9/22 in Assembly
Vote: 21

SENATE GOVERNANCE & FIN. COMMITTEE: 5-0, 6/29/22
AYES: Caballero, Nielsen, Durazo, Hertzberg, Wiener

SENATE APPROPRIATIONS COMMITTEE: 7-0, 8/11/22
AYES: Portantino, Bates, Bradford, Jones, Laird, McGuire, Wieckowski

ASSEMBLY FLOOR: 76-0, 5/25/22 - See last page for vote

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

SOURCE: Author

DIGEST: This bill 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 annually.

ANALYSIS:

- 1) 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 and remit appropriate tax at purchase and remit the amount to CDTFA.
- 2) Applies the sales tax whenever a retail sale occurs, which is generally any sale other than one for resale in the regular course of business.
- 3) Provides that 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, and requires the purchaser to remit use tax to CDTFA.

- 4) Sets the state sales and use tax rate at 7.25% of the sales price of the property sold or used.
- 5) Allows cities, counties, and specified special districts to increase the sales and use tax, also known as district or transactions and use taxes, up to a 2% countywide cap, with some exceptions.
- 6) Enacts 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 (AB 93, Committee on Budget, Chapter 69, Statutes of 2013, and SB 90, Committee on Budget and Fiscal Review, Chapter 70, Statutes of 2013). In 2017, the Legislature expanded and extended this exemption until July 1, 2030, as part of an agreement to extend the Global Warming Solutions Act (AB 398, E. Garcia, Chapter 135, Statutes of 2018).
- 7) Establishes the California Alternative Energy and Advanced Transportation Authority (CAEATFA) in the Office of State Treasurer, which provides financing through conduit or revenue bonds, loan guarantees, and loan loss reserves.
- 8) Creates CAEATFA's board, composed of the State Treasurer, State Controller, Director of Finance, Chairperson of the Energy Commission, and President of the Public Utilities Commission.
- 9) Excludes CAEATFA's purchases of tangible personal property from both the state and local shares of the sales and use tax.
- 10) Directs CAEATFA to administer up to \$100 million annually in state and local sales and use tax exclusions subject to an application and evaluation process, and board approval, for:
 - a) Manufacturers of alternative source technology used for renewable electricity generation or advanced transportation, which sunsets on January 1, 2021 (SB 71, Padilla, Chapter 10, Statutes of 2010);
 - b) Advanced manufacturing until January 1, 2016, (SB 1128, Padilla, Chapter 677, Statutes of 2012), which was extended to January 1, 2021 (AB 1269, Dababneh, Chapter 788, Statutes of 2015); and
 - c) 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, Chapter 768, Statutes of 2015).

- d) Extends CAEATFA's authority to allocate sales and use tax exclusions under each of the above categories from January 1, 2021, to January 1, 2026, (AB 176, Cervantes, Chapter 672, Statutes of 2019).
- 11) Allows CAEATFA to allocate exemptions to successful applicants under for programs up to \$100 million annually; however, CAEATFA can only allocate exemptions to projects that produce where the benefit to the state exceeds the benefit to the applicant.
 - 12) Sets forth the following criteria for CAEATFA to evaluate applications to determine whether the benefit to the state will exceed the benefit to the applicant:
 - a) 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
 - b) 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.
 - c) The extent of unemployment in the area in which the project is proposed to be located.
 - d) Any other factors CAEATFA deems appropriate.

This bill:

- 1) Increases the current authorization for CAEATFA to allocate sales and use tax exclusions from \$100 million to \$150 million annually.
- 2) Makes a conforming change.
- 3) Includes findings and declarations to comply with Section 41 of the Revenue and Taxation Code.

Background

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.

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."

Comments

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.

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, currently pending on the Senate Floor, AB 1951 (Grayson, 2022) converts 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.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Senate Appropriations Committee:

- 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.
- 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.

SUPPORT: (Verified 8/12/22)

State Treasurer Fiona Ma
Arrival Automotive USA
Clean Power Campaign
Los Angeles County Sanitation Districts
Republic Services

OPPOSITION: (Verified 8/12/22)

California State Association of Counties
California Teachers Association
League of California Cities

ARGUMENTS IN SUPPORT: According to the author, “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.”

ARGUMENTS IN OPPOSITION: According to the California State Association of Counties and the League of California Cities, “While we support California’s manufacturing industry generally and through local infrastructure incentives, local governments can ill-afford any additional erosion of sales and use tax revenues in the short or long-term. To the extent the exemption results in increased economic activity, the tax benefits will largely be enjoyed by the state general fund via increased personal income and corporation tax collections. Furthermore,

reductions in sales and use tax revenue will not only be borne by the local agencies that provide direct services to the manufacturing facility benefiting from the exemption, but also every county in the state due to the statewide formulas for distributing realignment funds for health, human services, and behavioral health

ASSEMBLY FLOOR: 76-0, 5/25/22

AYES: Aguiar-Curry, Arambula, Bauer-Kahan, Bennett, Bigelow, Bloom, Boerner Horvath, Mia Bonta, Bryan, Calderon, Carrillo, Cervantes, Chen, Choi, Cooley, Cooper, Cunningham, Megan Dahle, Daly, Davies, Flora, Mike Fong, Fong, Friedman, Gabriel, Gallagher, Cristina Garcia, Eduardo Garcia, Gipson, Gray, Grayson, Haney, Holden, Irwin, Jones-Sawyer, Kalra, Kiley, Lackey, Lee, Levine, Low, Maienschein, Mathis, Mayes, McCarty, Medina, Mullin, Muratsuchi, Nazarian, Nguyen, Patterson, Petrie-Norris, Quirk, Quirk-Silva, Ramos, Reyes, Luz Rivas, Robert Rivas, Rodriguez, Blanca Rubio, Salas, Santiago, Seyarto, Smith, Stone, Ting, Valladares, Villapudua, Voepel, Waldron, Ward, Akilah Weber, Wicks, Wilson, Wood, Rendon

NO VOTE RECORDED: Berman, O'Donnell

Prepared by: Colin Grinnell / GOV. & F. / (916) 651-4119
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**** END ****