SENATE THIRD READING
SB 302 (Padilla)
As Amended July 17, 2025
Majority vote

SUMMARY

Conforms to the federal treatment of certain federal emissions reduction tax credits.

Major Provisions

1) Excludes from gross income, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, any payment made, as provided in federal law, relating to the elective payment and the transfer of certain federal emissions reduction tax credits. The treatment of this authorization under federal law for partnerships and S corporations applies to this bill's exclusion.

2) Prohibits any deduction for an amount paid in consideration of a transferred federal emissions reduction tax credit.

3) Provides that, for the purposes of this bill, a payment made in consideration for the transfer of a "federal renewable resources tax credit" includes the value of the credit received by the transferee.

COMMENTS

1) *Federal emissions reduction tax credits*: Existing federal law authorizes a series of tax credits designed to incent certain emissions reduction activities in the generation of electricity, production of low- and no-emissions fuels, development of energy storage, and the manufacturing of energy efficient upgrades and goods, among other activities. California, however, does not conform to these credits as California does not automatically conform to federal tax law changes. Rather, California conforms to federal tax law as of a certain date, January 1, 2015, with certain modifications to those provisions, and provides that no federal tax credits or their carryover apply for state tax purposes unless otherwise provided. California has not conformed to these federal credits, and they do not apply for state tax purposes.

2) *The Inflation Reduction Act (IRA) (Public Law 117-169)*: According to the United States Department of Energy, the IRA represents the single largest investment in climate and energy in the nation's history. The IRA provided numerous financial incentives for various emissions reduction projects throughout the nation. Among these authorizations, the IRA enacted monetization mechanisms for certain federal emissions reduction tax credits. The first mechanism is the election to treat certain tax credits as a refund, and the second is the authorization to transfer credits.

3) *Election to treat as refund*: The IRC now allows certain tax filers to elect to treat their federal emissions reduction credit as a refund of overpayment. Generally, when a taxpayer fulfills their obligation to pay tax in excess of the liability, the taxpayer is entitled to a refund of the excess amount. Additionally, tax filers who generate credits, but who do not have sufficient taxable income to claim the entire amount of the credit, or who are exempt from taxation, would be unable to realize the full benefit of the tax credit generated. Thus, certain

tax filers earning certain credits may elect to treat the credit as an overpayment, thereby receiving a refund from the Internal Revenue Service (IRS), generally in an amount equal to the credit. This authorization essentially makes these credits refundable, without directly authorizing refundability.

4) *Transferability of credits*: In addition to the election authorization, the IRC allows taxpayers to transfer, or sell, credits they generate, subject to certain restrictions. In essence, this allows tax filers who have earned the credit to monetize the credit even if their tax liability is insufficient to claim a portion or all of the credit. Generally, transferable tax credits are sold at a discount of their face value. A tax credit worth $10 will be sold at a discount of, hypothetically, $9. This transaction allows the seller to gain financing immediately and provides the purchaser a decrease in tax liability. Thus, purchasers of credits are often investors seeking to offset their tax liability from other profitable ventures.

5) *Capital assets and their tax treatment*: Capital assets are assets expected to generate revenue and be useful for longer than one year. Thus, capital assets are not subject to standard treatment of income, but have separate rules for determining the taxable value attributable to these assets. When acquiring a capital asset, the cost of the asset forms the basis. This basis is subject to adjustment, as specified. Rather than deducting the cost of the capital asset in the year of acquisition, the basis may be depreciated over the expected operating life of the asset. When the asset is disposed of, the difference in the basis and the amount exchanged for the asset constitutes the gain or loss attributable to that asset. Capital gains and losses are summed, and the resulting amount is either taxable, if there is a cumulative gain, or generally eligible for deduction as a net operating loss in a different taxable year.

6) *IRS Memorandum 201147024*: Citing an IRS Office of Chief Counsel Memorandum issued in 2011, the FTB considers transferred credits as capital assets[1]. That memorandum addressed the tax treatment of certain Massachusetts State Tax Credits and pointed to case law justifying the IRS's treatment of these transferred credits as capital assets. The memo noted that the basis for the credit was the price paid by the purchaser, and that any difference between the price paid and the amount of the credit against tax liability was treated as a capital gain or loss, though Committee staff notes that it would be exceedingly unlikely for a purchaser to pay more than the face value of the credit.

7) *Public Law 119-21*: Recently enacted federal legislation begins to phase out many of the credits benefitting from the transferability and elective payment provisions in the IRA over the course of the next few years. Thus, certain credits would no longer be generated after their repeal, and the provisions of this bill could potentially be irrelevant for those credits.

According to the Author

The Federal IRA includes several clean energy investment incentives to accelerate our transition from fossil fuels. These incentives are necessary to spur clean energy development and make renewable projects possible. Currently, California law needs to conform with the new federal tax code for project developers to access those critical federal credits. If developers are unable to fully utilize these incentives, clean energy projects in California will cost more to build leading to higher ratepayer costs. California cannot afford to put extra costs on clean energy and

[1] IRS Office of Chief Counsel Memorandum 201147024 (Nov. 25, 2011)

ultimately to ratepayers and needs to conform our tax code with the IRA to unlock millions in federal tax incentives and bring down the costs of California's clean energy.

Arguments in Support
A coalition of electric generation companies, business organizations, and environmental advocates, writing in support of this bill, state, in part:

> In 2022, as part of the Biden administration's IRA, the federal government extended and established various tax credits to incentivize the production of clean energy and encourage businesses to develop projects that meet strong labor standards. The IRA also allowed taxpayers to transfer and sell specified federal environmental tax credits they generate, and specified income generated from the transfer of credits is not included in a taxpayer's gross income for tax purposes.
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> California does not conform to the federal government's treatment of environmental tax credits. Under existing law, any sales of these environmental tax credits are included in the seller's gross income and are not deductible by the purchaser. A majority of states have conformed to the federal rules regarding the non-taxability of transferred or sold environmental credits, making California's tax code particularly punitive to clean energy businesses.

Arguments in Opposition
None on file

FISCAL COMMENTS

1) General Fund (GF) revenue loss of an unknown, but definitely significant amount, the magnitude of which depends on the dollar amount and frequency of the excluded payments. By decreasing Personal Income Tax and Corporation Tax revenue, this bill also likely decreases Proposition 98 GF spending by approximately 40% of the GF revenue loss (the exact amount depends on the specific amount of the annual Proposition 98 guarantee).

   The Franchise Tax Board (FTB) notes that the recent creation of the federal elective payment and transferability provisions for IRA tax credits means there is little data regarding market participants and participants' potential tax burden to the state. However, initial data suggests a market of up to $23 billion in credit transfers annually. Assuming 15% of such market transactions are completed by California businesses with varying tax attributes, the FTB estimates revenue loss of up to $280 million resulting from excluding elective payments and credit transfers from gross income. However, this revenue loss is expected to decrease over time, as recent reductions to certain IRA tax credits signed into law by the Trump Administration begin to take effect.

2) Costs of an unknown amount to the FTB to administer the exclusion and prepare the report (GF). New tax expenditures generally result in absorbable administrative costs to the FTB, but the shifting federal landscape may make this exclusion more complex to administer.

VOTES

SENATE FLOOR: 38-0-2

YES: Allen, Alvarado-Gil, Archuleta, Arreguín, Ashby, Becker, Blakespear, Cabaldon, Caballero, Cervantes, Choi, Cortese, Dahle, Durazo, Gonzalez, Grayson, Grove, Hurtado, Jones, Laird, McGuire, McNerney, Menjivar, Niello, Ochoa Bogh, Padilla, Pérez, Richardson, Rubio, Seyarto, Smallwood-Cuevas, Stern, Strickland, Umberg, Valladares, Wahab, Weber Pierson, Wiener
ABS, ABST OR NV: Limón, Reyes

ASM REVENUE AND TAXATION: 7-0-0
YES: Gipson, Ta, Bains, Carrillo, DeMaio, McKinnor, Quirk-Silva

ASM APPROPRIATIONS: 15-0-0
YES: Wicks, Sanchez, Arambula, Calderon, Caloza, Dixon, Elhawary, Fong, Mark González, Ahrens, Pacheco, Pellerin, Solache, Ta, Tangipa

UPDATED

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