SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
2025 - 2026 Regular

Bill No:	SB 302	**Hearing Date:**	3/26/25
Author:	Padilla	**Tax Levy:**	No
Version:	2/10/25	**Fiscal:**	Yes
Consultant:	Grinnell		

PERSONAL INCOME TAX LAW AND CORPORATION TAX LAW: EXCLUSIONS: ENVIRONMENTAL CREDITS

Conforms state law to specific Internal Revenue Code sections added by the Inflation Reduction Act of 2022, relating to renewable energy development.

Background

Conformity. State law does not automatically conform to changes in federal tax law, except for specific retirement provisions. Instead, the Legislature must affirmatively conform to federal changes, which it can do in two different ways. First, the Legislature can pass an individual tax bill that conforms to a specific federal provision, such as the Regulated Investment Company Modernization Act (AB 1423, Perea, 2011). Second, the Legislature can pass one omnibus bill to ensure state law conforms to federal law as of a specified date. Currently, state law generally conforms to federal tax law as of January 1, 2015 (AB 154, Ting, 2015).

Income. Existing federal and state laws provide that gross income includes all income from any source, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, and qualified scholarships, among others.

Deductions. Business taxpayers can generally deduct from income for state and federal purposes the costs of carrying on a trade or business, so long as they are "ordinary and necessary." Generally, an ordinary expense is one that is common and accepted in the taxpayer's industry. A necessary expense is one that is helpful and appropriate for their trade or business.

Federal renewable energy tax credit. Since 2006, federal law has allowed an investment tax credit for renewable energy production, including solar energy. Currently, the credit is calculated as the energy percentage, which varies over time and by energy source, multiplied by the basis of the energy property when it is placed in service. Only taxpayers who own the renewable energy system can claim the credit.

Much like credits to construct low-income rental housing, many renewable energy developers do not have sufficient tax liability to fully utilize tax credits or depreciation deductions. As a result, they often form tax equity investment partnerships that transfer the credits and depreciation rights to investors, along with an income interest, in exchange for a cash equity investment and ownership rights.

Tax treatment of tax credits. When state law allows a taxpayer a credit against state taxes, it is not considered income to the extent the taxpayer uses it to reduce their tax liability. However, when taxpayers claim refundable credits that exceed their tax liability, or sell credits for consideration, the part of the credit that exceeds liability is considered income.[1] The IRS reasons that taxpayers have an accession to wealth when selling credits they cannot use.

Additionally, federal and state tax law treat state tax credits as assets when determining gain or loss.[2] As with other assets, taxpayers subtract the amount realized from the sale of an asset from its adjusted basis (usually its cost). If the difference is positive, the taxpayer has a taxable capital gain equal to the difference; if negative, the taxpayer has a capital loss of that amount. As a result, if a taxpayer purchases a tax credit at a discount, they generally have a taxable gain.[3]

Inflation Reduction Act (IRA). Signed into law by President Biden in August 2022, the IRA made several changes to tax incentives for producing renewable energy. Among these, the IRA added Section 6417 of the Internal Revenue Code (IRC) to allow applicable taxpayers, such as states and local agencies, tribal governments, and other tax-exempt entities, to elect to treat certain credits as a payment against their federal income tax liabilities rather than as a nonrefundable credit. Instead of claiming a credit, it is treated as an overpayment of taxes, resulting in a direct cash refund payment to the entity regardless of whether it has a tax liability owed. This “direct pay” election seeks to broaden the pool of potential investors able to benefit from renewable energy tax credits and offer an alternative to the traditional tax equity investment structure. Furthermore, IRC 6417 provides that these direct cash refund payments for this election are not taxable income, without which these entities may have a filing requirement when they are traditionally exempt from income tax except on their unrelated business taxable income.

The IRA also added IRC 6418, which provides that any income from transferring certain renewable energy credits must be classified as tax-exempt income. As a result, any income to the seller is excluded from tax, and the purchaser cannot claim a business expense deduction for the cost incurred to acquire the credit. Additionally, the U.S. Department of Treasury issued regulations to implement IRCs 6417 and 6418 which provided that taxpayers acquiring IRA credits did not have a taxable gain when claiming a transferred credit, even if the credit was purchased at a discount. IC 6417 and 6418 apply the following federal credits:

The federal elective payment and credit transfer provisions are allowed for the following federal tax credits:

- Energy Credit (IRC §48),
- Clean Electricity Investment Credit (IRC §48E),
- Renewable Electricity Production Credit (IRC §45),
- Clean Electricity Production Credit (IRC §45Y),
- Commercial Clean Vehicle Credit (IRC §45W, but elective pay option only),
- Zero-emission Nuclear Power Production Credit (IRC §45U),
- Advanced Manufacturing Production Credit (IRC §45X),
- Clean Hydrogen Production Credit (IRC §45V),
- Clean Fuel Production Credit (IRC §45Z),

[1] Internal Revenue Service (IRS) Office of Chief Counsel, Revenue Ruling 2024-004. November 26, 2004, citing among others, *Tempel v. Commissioner,* 13 T.C. 341 (2011).
[2] IRS Office of Chief Counsel, Chief Counsel Advice 201147024.
[3] Alyssa McLoughlin and Kathleen M. Quinn, “A Trap for the Unwary Purchaser of an IRA Tax Credit.” *Tax Notes State*, April 15, 2024.

- Carbon Oxide Sequestration Credit (IRC §45Q),
- Credit for Alternative Fuel Vehicle Refueling / Recharging Property (IRC §30C),
- Qualifying Advanced Energy Project Credit (IRC §48C).

Because California has not yet conformed to the changes the IRA made to the tax treatment of certain renewable energy credits, renewable energy developers must include the proceeds of the sale of tax credits as income, while purchasers can claim business expense deductions for amounts paid to purchase them, which is the opposite of federal law. Additionally, purchasers and transferees must include any difference between the amount of the credit and its purchase price as a taxable gain. Renewable energy developers want to conform state law to federal changes made by the IRA.

Proposed Law

Senate Bill 302 conforms state law to specific parts of IRC Sections 6417 and 6418, as added by the IRA. The bill explicitly excludes payments made to eligible taxpayers under IRC 6417 from income for state tax purposes, and provides no deduction is allowed for the same payment. The measure also provides that income does not include the value of a credit received by a transferee pursuant to IRC 6418.

SB 302 applies beginning in the 2023 taxable year, similar to federal law. The measure makes legislative findings and declarations supporting its purposes, and to comply with Section 41 of the Revenue and Taxation Code.

State Revenue Impact

According to the Franchise Tax Board (FTB), "Estimating the revenue impact of conforming to the exclusion from gross income for the election to receive a refund payment or conforming to the exclusion from gross income for the payment received by a transferor and the related elimination of the expense deduction by the transferee cannot be predicted. To determine the magnitude of the income exclusion and the disallowed deduction, both the dollar amount of the transaction and the frequency of transactions by California business would need to be known. Because it is difficult to predict the frequency and the value of future credit transfers, the revenue impact is unknown. However, should 15 percent of all transactions include a California business, the estimated impact to the General Fund could be a revenue gain or loss of about $250 million. In addition, because this bill is retroactive to taxable years beginning on or after January 1, 2023, the revenue impact for the first couple of years could exceed a $250 million revenue gain or loss as taxpayers amend prior year returns."

Comments

1. Purpose of the bill. According to the author, "the Federal Inflation Reduction Act (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 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."

2. Precedent. While most of California's tax credits are nonrefundable and nontransferable, state law has allowed for the sale of motion picture and television production tax credits attributable to independent films since the creation of the credit program in 2009. In 2023, the Legislature made that credit refundable (SB 132, Committee on Budget & Fiscal Review). Additionally, state law has long allowed for the sale of the state's Low-Income Housing Tax Credit to unrelated parties. While the credits that SB 302 affects are credits against federal, not state, taxes, the measure creates a precedent that tax credit purchasers do not have a taxable gain when purchasing tax credits at a discount for state tax purposes. As a result, purchasers of state tax credits would have taxable gains when buying and claiming these other state tax credits, but not the federal ones that SB 302 affects. Additionally, most taxpayers lack the means to purchase tax credits at a discount, but SB 302 would relieve these taxpayers from having to pay tax on any gain that results from a purchase.

3. Section 41. Section 41 of the Revenue and Taxation Code requires any bill authorizing a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve and detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). To satisfy these requirements, SB 302 states its goal, purpose, and objective is to promote the investment and construction of clean energy projects and clean energy advanced manufacturing facilities in California. The bill identifies the number of taxpayers who will utilize Sections 6417 and 6418 of the IRC for federal income tax credits in taxable years 2025 and later, as compared to investment in traditional tax equity structures in taxable years 2024 and before. The bill then directs the Franchise Tax Board (FTB) to annually collect data on the number of payments made to eligible taxpayers pursuant to Sections 6417 and 6418, relating to certain federal income tax credits, and compare the number of transactions to the investment in traditional tax equity structures in taxable years 2024 and before. FTB must then report this information to the Legislature on or before December 1, 2026, and each December 1 thereafter until 2036. Currently, FTB does not have the means to make this comparison because it can access neither the number of payments made to eligible taxpayers that occur after the bill becomes effective nor the number of transactions to the investment in traditional tax equity structures from prior years. Additionally, doing so by December 1, 2026, will be difficult, because most business entities won't file returns for 2025 until October of 2026. The Committee may wish to consider revising the measure's Section 41 findings and moving the report date requirement into the future.

4. Gift of Public Funds. Section Six of Article XVI of the California Constitution prohibits the Legislature from making a gift of public funds. By applying its provisions retroactively to the 2023 taxable year, SB 302 could be construed to constitute a gift of public funds; however, the bill includes provisions stating legislative intent that the bill serves a public purpose of promoting investment and construction of clean energy projects and clean energy advanced manufacturing facilities in California.

5. Related legislation. Last year, the Committee approved SB 1191 (Padilla), by a vote of 7 to 0, which is substantially identical to this bill. The measure was subsequently held on the Senate Appropriations Committee's Suspense File.

Support and Opposition (3/21/25)

Support: Advanced Energy United
American Clean Power - California
American Council on Renewable Energy (ACORE)

California Chamber of Commerce
California Efficiency Demand Management Council
California Energy Storage Alliance
California Taxpayers Association
Center for Energy Efficiency and Renewable Technologies
Clean Power Campaign
Clearway Energy Group LLC
Council on State Taxation
EDF Renewables
Family Business Association of California
Fluence
Independent Energy Producers Association
Invenergy, LLC
Kern County Taxpayers Association
Large Scale Solar Association
Marin Clean Energy (MCE)
Orange County Taxpayers Association
San Diego Community Power
Silicon Valley Leadership Group
Solano County Taxpayers Association
Solar Energy Industries Association
State Building & Construction Trades Council of California
The California Wind Energy Association (CALWEA)
Wellhead Electric Company, INC.

Opposition: None received.

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