



California State Board of Equalization

Legislative Bill Analysis

[Senate Bill 1340](#) (Hertzberg)

Date: August 15, 2022 (Amended)

Program: Property Taxes

Revenue and Taxation Code sections 64 and 73

Effective: Immediately

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Analysis Date: August 19, 2022

Summary: This bill would change the current new construction exclusion repeal date to January 1, 2027; specify any active solar energy system (ASES) that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership; specify section 41 reporting requirements do not apply to this bill; and strike all other provisions relating to sections 64.1, 64.2, 73.1, 73.2, 73.3 and 73.4.

Summary of Amendments: The **August 15, 2022**, amendments change the current new construction exclusion repeal date to January 1, 2027; specify any ASES that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership; specify section 41 reporting requirements do not apply to this bill; and strike all other provisions relating to sections 64.1, 64.2, 73.1, 73.2, 73.3 and 73.4.

Fiscal Impact Summary: Indeterminable.

Existing Law: Under the California Constitution, all property is taxable unless specifically exempted.¹ The Constitution limits the assessed value of property upon which the property tax is imposed. For property tax purposes, real property is reassessed to its current market value when real property undergoes a change in ownership or is newly constructed.² Generally, the law establishes a property's assessed value at its market value³ on the date purchased (base year value) and requires additional assessments to reflect certain construction activities that qualify as "new construction."

Change in Ownership. Different change in ownership laws apply to a person or legal entity who purchases or leases California real property than to a person or legal entity who obtains ownership interests in a legal entity (e.g., voting stock in a corporation, capital and profits in a limited liability company or partnership) that holds an interest in California real property.⁴ As a general rule, transfers of ownership interests in legal entities do *not* constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property.⁵ However, there are two exceptions wherein the transfer of ownership interests in a legal entity would trigger a change in ownership of the real property owned by the legal entity.

- **Change in Legal Entity Control.** Section [64\(c\)\(1\)](#) requires reassessment when any person or entity obtains control through direct or indirect ownership or control of more than 50 percent of corporation voting stock, or obtains a majority interest (more than a 50 percent ownership

¹ Article XIII, [section 1](#) of the California Constitution.

² California Constitution, article XIII A, [section 2](#); RTC section [110.1](#).

³ The assessed value is based on 1975 market value for property that has not changed ownership since that date.

⁴ California Constitution, article XIII A, section 2; RTC sections [60 – 69.5](#).

⁵ RTC section 64(a).

This staff analysis is provided to address various administrative, cost, revenue, and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

interest) in any other type of legal entity. The reassessment applies to all real property owned by the acquired legal entity (and any entity under its control).

- **Cumulative Transfers by "Original Co-owners."** Section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50 percent of the total interests in a legal entity are transferred by any of the "original co-owners" in one or more transactions.⁶ The reassessment applies to only the real property previously excluded from change in ownership under section [62\(a\)\(2\)](#).

New Construction. When substantial additions or alterations occur, the law requires the County Assessor to increase the assessment to reflect the value of "newly constructed" property.⁷ The County Assessor assigns the assessable new construction with its own distinct base year value. The remainder of the property's assessment is unaffected and retains its base year value.⁸ The Constitution allows the Legislature to provide that the term "newly constructed" does not include certain construction activities. These are commonly called "new construction exclusions." Any value added by these additions or alterations is not subject to be assessed, until the real property undergoes a change in ownership.

ASES New Construction Exclusion. The California Constitution⁹ grants the Legislature the authority to exclude the construction or addition of any ASES from the definition of assessable new construction. Section [73](#) implements the new construction exclusion, which is available through the 2023-24 fiscal year. Section 73 is scheduled to sunset on January 1, 2025. Any ASES that was excluded prior to this date will continue to be excluded until a change in ownership occurs.

In 2011, the Legislature added findings and declarations,¹⁰ which provide that in cases where a newly constructed ASES is sold or transferred in sale-leaseback arrangements, partnership flip structures, or other transactions to take advantage of federal tax benefits, the ASES new construction exclusion applies, as long as (1) the system is newly constructed or added, and (2) no other taxpayer has received the exclusion for that same system. The new construction exclusion remains in effect only until there is a subsequent change in ownership.

Proposed Law: Extends Section 73 Repeal Date. The **August 15, 2022**, amendments extend the section 73 repeal date from December 31, 2025, to January 1, 2027. The amendments additionally specify any ASES that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership.

⁶ **Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation.** Under section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests of the transferors and transferees in the real property transferred are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the person(s) or entity(ies) holding ownership interests in the legal entity immediately after the transfer are considered "**original co-owners**" for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50 percent, the real property previously excluded from reassessment under RTC section 62(a)(2), is subject to reassessment under RTC section 64(d), absent an applicable exclusion.

⁷ Article XIII A, section 2 of the California Constitution (Proposition 13) and RTC section [70](#). Additionally, "supplement assessment" laws make the new construction taxable as of the completion date.

⁸ Unless the new construction replaces certain types of existing improvements, in which case the value attributable to those preexisting improvements is deducted from the property's existing base year value.

⁹ Article XIII A, section 2(c)(1).

¹⁰ [ABx1 15](#), Ch. 3, Stats. 2011.

Findings and Declarations. The Legislature finds and declares that section 73 was enacted to encourage and to provide incentives for the development of ASES by providing an exclusion from classifications as newly constructed the construction or addition of ASES.

No Reimbursement. Any local property tax dollars lost pursuant to the bill's provisions will not be reimbursed by the state.

Effective Date. If enacted, these provisions will become effective immediately.

In General: Property Tax System. Article XIII, section 1 of the California Constitution provides that all property is taxable at the same percentage of "fair market value," unless specifically exempted, or authorized for exemption. Article XIII A, section 2 of the California Constitution defines "fair market value" as the County Assessor's opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the "base year value." Annual adjustments to the base year value are limited to 2 percent or the rate of inflation, whichever is less. Article XIII A, section 2 also provides for certain exclusions from consideration as a "change in ownership" and "newly constructed" as approved by voters via constitutional amendments.

New Construction. The California Constitution does not define the terms "new construction" or "newly constructed." Section 70 defines these terms, in part, to mean:

- Any addition to real property, whether land or improvements (including fixtures) since the last lien date.
- Any alteration of land or any improvements (including fixtures) since the last lien date that constitutes a "major rehabilitation" or that converts the property to a different use.

A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

With respect to any new construction, the law requires the County Assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements qualifying as "new construction" and is added to the property's existing base year value. When new construction replaces certain types of existing improvements, the value attributable to those pre-existing improvements is deducted from the property's existing base year value.¹¹

New Construction Exclusions. Certain types of construction activity are excluded from assessment as "new construction" via constitutional amendment. Consequently, while these improvements may increase the value of the property, the additional value is not assessable. Relevant to this bill, Proposition 7, approved by California voters in November 1980, created an exclusion for ASES.

Overview of Solar Energy New Construction Exclusion. An "active solar energy system" is defined in section 73 as a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. An ASES may be used for any of the following:

- Domestic, recreational, therapeutic, or service water heating
- Space conditioning

¹¹ Section [71](#).

- Production of electricity
- Heat processing
- Solar mechanical energy

An ASES includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items. "Parts" includes spare parts that are owned by the owner of, or maintenance contractor for, an ASES for which the parts were specifically purchased, designed, or fabricated for installation in that system. Such a system includes only equipment used up to, but not including the stage of conveyance or use of the electricity.

An ASES also includes pipes and ducts that are used exclusively to carry energy derived from solar energy. Pipes and ducts that are used to carry both energy derived from the sun and energy derived from other sources may be considered ASES property only to the extent of 75 percent of their full cash value.

This exclusion is scheduled to sunset on January 1, 2025. Any ASES that was completed and excluded from assessment prior to this date will continue to be excluded until a change in ownership occurs.

An ASES does not include auxiliary equipment, such as furnaces and hot water heaters, that use a source of power other than solar energy to provide usable energy. Dual use equipment, such as ducts and hot water tanks, that is used by both auxiliary equipment and solar energy equipment is considered ASES property only to the extent of 75 percent of its full cash value.

Section 73 explicitly provides that the exclusion does not apply to solar swimming pool heaters or hot tub heaters. By definition, the exclusion does not apply to "passive" solar systems. Lastly, the exclusion does not apply to wind energy systems.

Exclusion Extended to Initial Purchaser. Section 73 was amended in 2008¹² to extend the new construction exclusion after a change in ownership if a new building is initially constructed with an ASES incorporated and subsequently sold by the developer through the 2015-16 fiscal year. Specifically, in the case where an ASES is incorporated by an owner-builder in the initial construction of a new building that the owner-builder does not intend to occupy or use (i.e., a building offered for sale, such as a new home in a subdivision or a new warehouse), the exclusion for the system applies to the building's first buyer if (1) the owner-builder did not receive the exclusion for the same system, (2) if the initial buyer purchased the new building prior to that building becoming subject to reassessment to the owner builder,¹³ and (3) a claim¹⁴ is filed with the County Assessor.

Section 73 was amended in 2014 to extend the exclusion through the current 2023-24 fiscal year.¹⁵

If the exclusion is eligible to be extended to the initial purchaser, then in determining the base year value to be established as a result of the change in ownership, the base year value is reduced by the portion of the purchase price that is attributable to the ASES. Thereafter, any subsequent change in ownership of the property ends the exclusion of the value of the ASES from property tax.

Common Transactions that may be Eligible for Federal Tax Benefits. Under the 2011 legislative intent language, newly constructed ASES continue to receive the property tax exclusion if they are transferred

¹² [AB 1451](#), Ch. 538, Stats. 2008.

¹³ Section 73(e)(1).

¹⁴ Section 73(e)(1)(A); [BOE-64-SES](#), *Initial Purchaser Claim for Solar Energy System New Construction Exclusion*.

¹⁵ [SB 871](#), Ch. 41, Stats. 2014.

using certain transactions that require the ASES to be sold or transferred to a third party that may qualify for federal tax benefit. Transactions that may be eligible for federal tax benefits include, but are not limited to, the following:

- *Sale-leaseback transactions* involve the sale of a property in which the seller immediately begins to lease the property from the buyer. Thus, the seller no longer has ownership of the property, but operates it for the duration of the lease agreement.
- A *partnership flip transaction* is a financing arrangement between a renewable energy developer and a single or multiple tax investors whereby the parties form a partnership or limited liability company to develop and/or own an ASES. This structure involves the tax investor making an investment in the partnership or limited liability company in exchange for the majority of the tax attributes (i.e., federal tax credits, depreciation, and net income) until the investor achieves its pre-established yield. The investor's share of these items is then reduced. The transaction is known as the "flip."

In the case of a partnership flip transaction, if the investment made by the tax investor causes it to obtain more than 50 percent of the capital and profits interests of the partnership or limited liability company (either upon the making of the initial investment or pursuant to subsequent changes in the capital and profits percentages owned by the investor required by the partnership or operating agreement), the change in control is excluded by the new construction exclusion and no reassessment of the ASES will occur. Once the investors achieve a pre-established yield or until after a pre-established period of time, at which time the tax attributes are reduced, and the developer obtains a majority of both the capital and profit interests of the partnership or limited liability company, no change in ownership or reassessment will occur. This type of transaction is limited to one with respect to any portion of an ASES.¹⁶

Legal Entity Change in Control or Ownership. County Assessors discover most real property changes in ownership via grant deeds or other documents recorded with the County Recorder. However, real property owned by a legal entity may undergo a "change in control or ownership" with no grant deed or other document recorded that could alert the County Assessor to a reassessment. These types of changes in control or ownership are reported directly to the BOE Legal Entity Ownership Program (LEOP) by the person or entity involved.

Existing law¹⁷ requires legal entities to file a change in ownership statement (LEOP COS) with the BOE within 90 days of a change in control or ownership under section 64(c) or (d). In the case of a change in control under section 64(c), the person or legal entity that *acquired* control of the legal entity is responsible for filing the LEOP COS.

In addition to the self-reporting requirement to file a LEOP COS, the BOE may send a LEOP COS to an entity to complete and file with the BOE. Annually, the BOE canvasses legal entities with a query on the California Franchise Tax Board income tax return. County Assessors and other interested parties may send referrals reporting possible changes.

Once the BOE determines that a legal entity has undergone a change in control or ownership, the BOE notifies County Assessors of those legal entities' changes in control or ownership.

¹⁶ [SB 267](#), Ch. 424, Stats. 2021.

¹⁷ Sections [480.1](#) and [480.2](#).

Commentary:

1. **Summary of Amendments.** The **August 15, 2022**, amendments change the current new construction exclusion repeal date to January 1, 2027; specify any ASES that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership; specify section 41 reporting requirements do not apply to this bill; and strike all other provisions relating to sections 64.1, 64.2, 73.1, 73.2, 73.3 and 73.4.
2. **Section 73 is not a real property tax "exemption" for solar energy facilities, but a new construction "exclusion."** The new construction exclusion was created in 1980 via Proposition 7 to provide that the construction or addition of an ASES to an existing property, by itself, would not lead to a revaluation of the property for property tax purposes. A new construction exclusion terminates if there is a transfer of the property resulting in a property's change in ownership (a reappraisal event). In the case of any locally assessed large scale solar project, only the ASES improvements are eligible for the new construction exclusion, while the land remains subject to property tax.¹⁸
3. **State assessed properties are not eligible for the new construction exclusion because it is only applicable to locally assessed property.** In *ITT World Communications, Inc. v. City and County of San Francisco* (1985) 37 Cal.3d 859, the California Supreme Court ruled that Proposition 13's (article XIII A) assessment rollback, its 2 percent limit on annual assessment growth, and its limit on current market value assessment only upon a change in ownership or new construction did not apply to state-assessed property, only to locally assessed property. As a result, taxable property in California is now generally split into two major categories: locally assessed property subject to article XIII A assessment limitations and state-assessed property not subject to those assessment limitations. Thus, ASES owned by public utilities and subject to BOE assessment do not benefit from the section 73 new construction exclusion; value of these properties would continue to be captured under the unitary approach to value.

Costs: The BOE estimates a total agency cost of \$1,734 and 21 personnel hours would be attributable to issuing one Letter to Assessors to inform County Assessors of the change in law and updating Assessors' Handbooks Sections.

Revenue Impact: This bill's revenue impact depends on how many systems apply under the bill's provisions. The BOE does not have this data available; thus, the revenue impact is indeterminable.

¹⁸ If the land is government owned, the land could become subject to a possessory interest. Generally, a taxable possessory interest exists when a taxpayer possesses an interest in government real property that is durable, independent, exclusive of the rights held by others in the real property and the interest provides a private benefit to the possessor.