

[Senate Bill 364](#) (Mitchell)

Date: As Proposed to be Amended on July 27, 2020

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Sections 73, 83-88, 105, and 106

Effective: Upon voter approval

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**Summary:** As proposed to be amended and subject to voter approval of Proposition 15 on the November 3, 2020 ballot, this bill specifies that nonresidential active solar energy systems are personal property and creates an exemption for nonresidential active solar energy systems until the solar energy system undergoes a subsequent change in ownership.

**Fiscal Impact Summary:** The revenue impact is indeterminable.

**Existing Law:** Under article XIII, section [1](#), of the California Constitution, all property is taxable and assessed at fair market value, unless otherwise provided by the California Constitution or the laws of the United States.

Personal property includes all property, except real property.<sup>1</sup> "Real property" includes land; all mines, minerals, and quarries in the land; all standing timber; and improvements.<sup>2</sup> "Improvements" include all buildings, structures, fixtures, and fences erected on or affixed to the land; all fruit, nut bearing, or ornamental trees and vines, not of natural growth, and not exempt from taxation, except date palms under eight years of age.<sup>3</sup> A "fixture" is considered real property if it is physically or constructively attached to real property with the intent that it remain attached indefinitely.<sup>4</sup>

**Personal Property Taxation.** Section [2](#) of article XIII authorizes the Legislature to provide for property taxation of tangible personal property. Generally, all tangible personal property is taxable except where specific exemptions are provided. Examples of taxable tangible personal property include portable machinery and equipment, office furniture, tools, and supplies. Examples of current exemptions include business inventories, personal household furnishings, personal effects, and pets.

Personal property is annually assessed at its current market value to persons owning, claiming, possessing, or controlling it on the lien date, January 1.

**Assessment of Interests in Real Property.** Section [2](#) of article XIII A of the California 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.<sup>5</sup>

A change in ownership is a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.<sup>6</sup> Generally, the law

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<sup>1</sup> Revenue and Taxation Code (RTC) section [106](#).

<sup>2</sup> RTC section [104](#).

<sup>3</sup> RTC section [105](#).

<sup>4</sup> Property Tax Rule [122.5](#).

<sup>5</sup> California Constitution, article XIII A, [section 2](#); RTC section [110.1](#).

<sup>6</sup> RTC section [60](#).

*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.*

establishes a property's assessed value at its market value<sup>7</sup> on the date it changes ownership (base year value) and requires additional assessments to reflect certain construction activities that qualify as "new construction." The law requires the assessor to establish a "base year value" for real property at its 1975 market value and thereafter reset the value to current market value every time the property changes ownership or new construction is completed.<sup>8</sup> The base year value must be compounded annually by an inflation factor not to exceed 2 percent.<sup>9</sup> The inflation-adjusted value is called the "factored base year value."

**Transfer of Interests in Legal Entities.** RTC section [64](#) sets forth the change in ownership provisions for the purchase or transfer of ownership interests in legal entities (e.g., stock in a corporation, membership interests in a limited liability company, or interests in a partnership) that own real property. As a general rule, under RTC section 64(a), 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. However, there are two exceptions wherein the transfer of ownership interests in a legal entity would trigger a change in ownership:

- **Change in Legal Entity Control.** RTC 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 more than a 50 percent ownership 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."** RTC 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.<sup>10</sup> The reassessment applies to only the real property previously excluded from change in ownership under RTC section 62(a)(2).

**New Construction.** When substantial additions or alterations occur, the law requires the assessor to increase the assessment to reflect the value of "newly constructed" property.<sup>11</sup> The 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.<sup>12</sup> The Constitution allows the Legislature to provide that the term "newly constructed" does not include certain construction activities. These are

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<sup>7</sup> The assessed value is based on 1975 market value for property that has not changed ownership since that date.

<sup>8</sup> RTC section [110.1](#)(a) and (b).

<sup>9</sup> RTC section 110.1(f) and section [51](#).

<sup>10</sup> **Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation.** Under RTC 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 in the real property are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the persons 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 deemed to undergo a change in ownership, and is, therefore, subject to reassessment under RTC section 64(d).

<sup>11</sup> 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.

<sup>12</sup> 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.

commonly called "new construction exclusions." Any value added by these additions or alterations is not subject to the property tax, until the real property undergoes a change in ownership.

**Active Solar Energy System New Construction Exclusion.** The California Constitution<sup>13</sup> grants the Legislature the authority to exclude the construction or addition of any active solar energy system from the definition of assessable new construction. Revenue and Taxation Code (RTC) 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 active solar energy system that was excluded prior to this date will continue to be excluded until a change in ownership occurs.

**Proposed Law:** Subject to voter approval, until January 1, 2025, this bill provides that nonresidential active solar energy systems are personal property and exempt from taxation until the system undergoes a subsequent change in ownership.

**Effective Date.** This bill takes effect upon voter approval of Proposition 15 on the November 3, 2020 ballot, which proposes to add section 2.5 to article XIII A of the California Constitution. If enacted, effective with the operative date, the new construction exclusion contained in section 73 will not apply to nonresidential active solar energy systems. The bill's proposed exemption of nonresidential active solar energy systems will apply to systems installed on or before January 1, 2025.

**Intent.** This bill specifies that it is the intent of the Legislature to ensure that active solar energy systems that would have been exempt from taxation because of the new construction exclusion continue to be exempt from taxation until there is a subsequent change in ownership of the active solar energy system.

**New Construction Exclusion for Active Solar Energy Systems.** This bill specifies that the existing new construction exclusion for active solar energy systems will not apply to nonresidential active solar energy systems, if this bill becomes operative.

**Nonresidential Active Solar Energy System.** A "nonresidential active solar energy system" is a system that uses solar devices to provide for the collection, storage, or distribution of solar energy, and that is not constructed or installed in or on residential property. Such a system does not include solar swimming pool or hot tub heaters. A nonresidential active solar energy system may be used for any of the following:

- Recreational, therapeutic, or service water heating
- Space conditioning
- Production of electricity
- Heat processing
- Solar mechanical energy

Generally, the use of solar energy in the production of electricity involves the transformation of sunlight into electricity through the use of devices such as solar cells or other solar collecting equipment. A nonresidential active solar energy system 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 active solar energy system 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.

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<sup>13</sup> Article XIII A, section 2(c)(1).

A nonresidential active solar energy system 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 part of the nonresidential active solar energy system property only to the extent of 75 percent of their full cash value.

A nonresidential active solar energy system 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 part of the nonresidential active solar energy system property only to the extent of 75 percent of its full cash value.

**Residential Property.** "Residential property" means real property used as residential property, including both single-family and multiunit structures, and the land on which those structures are constructed or placed.

**Subsequent Change in Ownership.** This bill provides that a nonresidential active solar energy system constructed or installed before January 1, 2025 will be exempt from taxation until there is a subsequent change in ownership. A change in ownership will be deemed to have occurred if the transaction would have constituted a change in ownership under chapter 2 of the Revenue and Taxation Code (beginning with section 60), had the nonresidential active solar energy system been real property instead of personal property.

**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.

**Business Personal Property.** All property, real and personal, is subject to property tax, unless a specific constitutional or statutory exemption applies. Generally, taxability is determined on the lien date, which is January 1 of each year. The Constitution allows the Legislature to exempt or provide for differential taxation of any personal property with a 2/3 vote.

Personal property used in a trade or business is taxable. Proposition 13's valuation limitations do not apply to business personal property. Consequently, the law requires the assessor to determine its current fair market value every year as of January 1. Mass appraisal techniques generally are necessary given the enormity of this task. To aid in the task, the law requires property owners to annually report their personal property holdings with an aggregate acquisition cost of \$100,000 or more on a business property statement.<sup>14</sup>

The assessor determines the fair market value of most business personal property using the property's acquisition cost. The assessor multiplies acquisition cost by a price index (an inflation trending factor based on acquisition year) to estimate reproduction cost new. Next, the assessor multiplies reproduction cost new by a percent good factor (from BOE-issued percent good tables) to estimate depreciated reproduction cost (reproduction cost new less depreciation). The assessor uses the reproduction cost new less depreciation value as the property's taxable value for the fiscal year. The personal property tax rate is the same as the real property tax rate, which is 1 percent plus voter approved indebtedness in the locality. The BOE's Assessors' Handbook Section [504](#), *Assessment of Personal Property and Fixtures*, provides more detailed guidance.

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<sup>14</sup> RTC section [441](#).

**Real Property.** Article XIII A, section 2 defines "fair market value" as the 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 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 active solar energy systems.

**Overview of Solar Energy New Construction Exclusion.** An "active solar energy system" is defined in RTC 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 active solar energy system may be used for any of the following:

- Domestic, recreational, therapeutic, or service water heating
- Space conditioning
- Production of electricity
- Heat processing
- Solar mechanical energy

An active solar energy system 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 active solar energy system 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 active solar energy system 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 active solar energy system property only to the extent of 75 percent of their full cash value.

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

An active solar energy system 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 active solar energy system property only to the extent of 75 percent of its full cash value.

RTC 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 energy systems. Lastly, the exclusion does not apply to wind energy systems.

**Exclusion Extended to Initial Purchaser.** RTC section 73 was amended in 2008<sup>15</sup> to extend the new construction exclusion after a change in ownership if a new building is initially constructed with an active solar energy system incorporated and subsequently sold by the developer. Specifically, in the case where an active solar energy system 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,<sup>16</sup> and (3) a claim<sup>17</sup> is filed with the County Assessor.

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 active solar energy system. Thereafter, any subsequent change in ownership of the property ends the exclusion of the value of the active solar energy system from property tax.

**Common Transactions that may be Eligible for Federal Tax Benefits.** Under the legislative intent language contained in [ABx1 15](#) (Stats. 2011, ch. 3), newly constructed active solar energy systems continue to receive the property tax exclusion if they are transferred using certain transactions that require the active solar energy system 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 active solar energy system. 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 reduction 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 active solar energy system will occur. However, if the developer or a third party subsequently obtains more than 50 percent of the capital and profits interests of the partnership or limited liability company, a change in control and reassessment of the active solar energy system will occur.<sup>18</sup>

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<sup>15</sup> [AB 1451](#) (Stats. 2008, ch. 538).

<sup>16</sup> RTC section 73(e)(1).

<sup>17</sup> RTC section 73(e)(1)(A); [BOE-64-SES](#), *Initial Purchaser Claim for Solar Energy System New Construction Exclusion*.

<sup>18</sup> Letter To Assessors [2012/053](#), *Guidelines for Active Solar Energy Systems New Construction Exclusion*.

**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 State Board of Equalization's (BOE) Legal Entity Ownership Program (LEOP) by the person or entity involved.

Existing law<sup>19</sup> 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 RTC section 64(c) or (d). In the case of a change in control under RTC 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.

### **Commentary:**

1. **Effective Date.** These provisions take effect only if Proposition 15, the split roll initiative, is enacted by the voters at the November 3, 2020 election.
2. **Personal Property Classification for Nonresidential Active Solar Energy System.** This bill specifies that a nonresidential active solar energy system is personal property, not real property, unlike a residential active solar energy system. This creates a hybrid type of property, in that a nonresidential active solar energy system is considered personal property, but will be subject to assessment only after it undergoes a change in ownership.
3. **Personal Property Exemption.** This bill specifies that a nonresidential active solar energy system that is installed on or before January 1, 2025 is exempt from taxation, until the system undergoes a subsequent change in ownership. This bill clarifies that the exemption applies to a nonresidential active solar energy system that is constructed or installed prior to the date Chapter 4.5 becomes operative, only if that system would have been excluded from assessment under section 73, if the system had been real property instead of personal property. Essentially, this is treating a nonresidential active solar energy system the same as a residential active solar energy system in that, upon installation, neither are assessable until the system undergoes a change in ownership.
4. **Section 73 is not a real property tax "exemption" for active solar energy systems, 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 active solar energy system to real 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).

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<sup>19</sup> RTC sections [480.1](#) and [480.2](#).

5. **Termination of New Construction Exclusion.** Under section 73, the new construction exclusion for an active solar energy system terminates if a change in ownership (a reappraisal event) occurs. For an excluded active solar energy system that is owned by a legal entity, if a person or entity subsequently obtains more than 50 percent of a corporation's voting stock or the capital and profits interests of a partnership or limited liability company that owns the active solar energy system, the change in control of the legal entity will result in a reassessment of any real property owned by the legal entity, including any excluded active solar energy systems.

Section 73 is scheduled to sunset on January 1, 2025, unless this date is extended. This means that any active solar energy system that is constructed on or after January 1, 2025 will be assessable upon completion of construction. If this bill is enacted, any residential active solar energy system that is constructed on or after January 1, 2025 will be assessable, unless this sunset date is extended.

Consistent with this sunset date in section 73, this bill specifies that the exemption does not apply to a nonresidential active solar energy system that is constructed on or after January 1, 2025.

6. **Split Roll Initiative.** Typically, the term "split roll" means taxing various property types (for example, residential v. commercial) according to a different tax rate or value standard. A true "split roll" is not possible without a constitutional amendment. Proposition 15 (Initiative 1870, [19-008A1](#)), which is on the November 3, 2020 ballot, proposes to amend the Constitution to require certain commercial and industrial real property to be taxed at fair market value. If Proposition 15 is enacted, this bill, by classifying nonresidential active solar energy systems as personal property, will defer assessment of any system constructed before January 1, 2025 until the lien date following the date of change in ownership. Any nonresidential active solar energy system that is constructed on or after January 1, 2025 will be assessed at fair market value, along with other commercial and industrial property.
7. **Technical Issue.** This bill provides that for purposes of article XIII A of the California Constitution, nonresidential active solar energy systems are personal property. Personal property is assessed under article XIII, not article XIII A. Should new section 83.5 reference both article XIII and XIII A?
8. **Related Legislation.**
- [Assembly Bill 105](#) also provides that, subject to voter approval of the split roll initiative, nonresidential active solar systems are personal property and creates an exemption for nonresidential active solar systems until the solar system undergoes a subsequent change in ownership. AB 105 passed the Senate and is in the Assembly for concurrence (assigned to the Revenue and Taxation Committee).
  - [Senate Bill 1059](#) provides a change in ownership exclusion for an active solar energy system that is owned by a legal entity that has undergone a change in control. SB 1059 was assigned to the Governance and Finance Committee.

**Costs:** The BOE would incur some minor absorbable costs to inform and advise County Assessors of the change in law.

**Revenue Impact:** This bill goes into effect if Proposition 15, the split roll initiative, is approved by the voters on November 3, 2020. If Proposition 15 and this bill are enacted, nonresidential active solar

energy systems, that would otherwise be subject to annual reassessment, will be exempt from taxation, if installed on or before January 1, 2025. This bill's revenue impact depends on how many active solar energy systems are attached to commercial or industrial property and the annual market value of the active solar energy system. The value of an active solar energy system is variable and depends on the features of each system on a case-by-case basis. It is unknown how many active solar energy systems are located on commercial or industrial properties. The BOE does not have this data available; thus, the revenue impact is indeterminable.