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California Establishes Tax Break for Clean Tech Manufacturing Companies

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On March 24, 2010, California Governor Schwarzenegger signed legislation to enable solar, wind, and other "clean technology" companies to exclude their purchases of manufacturing equipment from the state sales tax. Under the bill, SB 71, the sales tax exemption takes effect immediately and will continue for ten years. As discussed below, participation in the development of SB 71's implementing regulations will be key to ensuring eligibility and obtaining priority for the exemption.

Background

California's base statewide sales tax rate is 8.25%. With supplementary sales and use taxes added by cities, counties, local districts and other authorities, the total sales tax rate is as high as 10.75% in some parts of California. With a narrow exception, purchases of clean tech manufacturing equipment in California have been subject to this relatively high state sales tax.

The new tax break will be administered by the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA), a state authority established in 1980 to encourage the development of alternative energy sources and advanced transportation technologies. CAEATFA was able to provide financial assistance for projects utilizing these energy sources and technologies using bonds, loans, loan guarantees, and credit enhancements.

Prior to enactment of the new legislation, CAEATFA could provide a sales tax exemption only for the purchase of new manufacturing equipment for zero-emission vehicles and related technologies.[1] It lacked authority to provide an exemption for the purchase of equipment used to manufacture solar panels, wind turbines, and other clean tech products.

SB 71

The new legislation greatly expands the range of projects that CAEATFA may exempt from the state sales tax to include all clean tech manufacturers.[2] Specifically, SB 71 authorizes CAEATFA to approve a sales tax exemption for purchase of "tangible personal property that is utilized for the design, manufacture, production, or assembly of advanced transportation technologies or alternative source products, components, or systems."[3] The tax exemption will remain in effect until January 1, 2021.

For purposes of CAEATFA's financial incentives, the law already defined "alternative sources" to include cogeneration technology, energy conservation, solar, biomass, wind, geothermal, small-scale hydroelectric, and other energy-efficient technologies that reduce the use of fossil fuels or nuclear

fuels. With enactment of SB 71, these "alternative sources" also will include advanced electric distributive generation technology and energy storage technologies.

CAEATFA will administer the sales tax exemption by evaluating project applications on a case-by-case basis. The new legislation identifies a number of criteria that CAEATFA will use when evaluating projects, including economic measures such as the extent to which the project creates new, permanent jobs in California. The criteria also include the degree to which a project results in a reduction of greenhouse gas (GHG) emissions, air or water pollution, or energy consumption, or an increase in energy efficiency, beyond the level required by existing law.[4]

SB 71 received rare unanimous support in both houses of the California Legislature. This may have been due in part to the author's assertion that California was one of only three states that did not provide a sales tax exemption or tax credit for the purchase of clean tech manufacturing equipment. Implementation of the new legislation will be guided by regulations to be prepared by the State Treasurer's Office.

Key Implications

Enactment of SB 71 has the following key implications:

- The state sales tax exemption will apply broadly to a wide range of transactions, and the amount of potential tax revenue subject to the exemption is not capped.
- Clean tech manufacturers will save tens of millions of dollars by utilizing the exemption from California's sales tax, which is as high as 10.75% in some parts of the state.
- The process and priority for obtaining the exemption will be determined by forthcoming "emergency regulations" that will be finalized after an expedited public participation process. Participation in formulation of the regulations by the State Treasurer's Office will be key to ensuring eligibility and obtaining priority.
- In the future, business interests may seek to extend the California sales tax exemption to purchases of equipment by companies in other manufacturing sectors.

Conclusion

The new exemption from California's sales tax will benefit clean tech manufacturers located in California and provide an incentive for clean tech companies to locate manufacturing facilities in the state. Businesses that intend to apply for the exemption should consider participating in the expedited process for developing regulations to implement the new legislation. Paul Hastings attorneys already are deeply involved with decision-makers in the State Treasurer's Office, have significant experience assisting stakeholders with such processes in California, and are available to assist clean tech companies in this regard.

SB 71 is the latest in numerous changes in state and federal laws that directly affect renewable energy companies. Paul Hastings lawyers have been involved in these developments and will continue to actively monitor and participate in matters that affect the clean tech sector.

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[1] For example, CAEATFA approved one such project for electric car manufacturer Tesla Motors in 2009.

[2] The California Governor's Office estimates that more than 10,000 clean tech companies are located in California.

[3] California Public Resources Code §§ 26003(g)(2), 26011.8(a)-(b).

[4] The criteria, which are set forth at California Public Resources Code § 26011.8(d), also include whether the anticipated benefit to the state from the project exceeds the tax benefit to the manufacturer requesting the exemption.