

Proposed CAEATFA Regulatory Modifications for Program Development and Incorporation of AB 199

June 22, 2016 Workshop

California recently established a new law to expand CAEATFA's existing Sales and Use Tax Exclusion Program (STE Program) to include Recycled feedstock (RF) projects. This document outlines modifications to the proposed regulation text to incorporate changes contained in AB 199 (Eggman, 2015), as well as modifications to the overall Program structure and application process.

For more detailed information on the existing program, please see the [current program summary document](#).

For the proposed regulation text, please [click here](#).

AB 199 Implementation Proposal

AB 199 Process Overview

1. Applicants' Projects must satisfy the definition of "Recycled feedstock" set forth in statute (see below).
2. Projects must score at least 1,000 points in the net benefits test, with a minimum of 20 environmental points. See Section 10033(c)(6).
3. Administration – allocation of STE based on availability and per project cap of \$20 million, as outlined in Section 10032(a)(4). Upon approval of an Application by the CAEATFA Board, Applicants will:
 - a. Enter into a Master Agreement with the Authority
 - b. Prepare a certificate, pursuant to BOE guidelines, which will be provided to suppliers to exempt both state and local sales tax from purchases of qualified property.
 - c. Report semi-annually to the Authority.

AB 199 Eligibility

To be eligible for the (Recycled feedstock) STE Program, Applicants must satisfy the definitions of "Project" and "Recycled feedstock" as listed in Public Resources Code Sections 26011.8(b)(1) and (2). Applicants will provide evidence in Part A of the Application that they satisfy the criteria for being classified as a Recycled feedstock Project under the terms of the Program. RF projects include those that are not eligible to apply for a sales and use tax exclusion as an Alternative Source (AS), Advanced Transportation (AT), or Advanced Manufacturing (AM) per Section 10031(aa).

AB 199 Evaluation Criteria

Applicants for the (Recycled feedstock) STE Program will be subject to a net benefits test similar to the one currently used for AS and AT applications. Specifically, Applicants will need to demonstrate both fiscal and environmental benefits (including a minimum environmental benefits score of 20 points).

Fiscal benefits will be measured in the same fashion as currently employed for AS and AT Applicants. Specifically, the additional (marginal) economic activity generated by the STE will be estimated along with the corresponding fiscal impact based on information provided by the Applicant, including, but not limited to, the project's projected revenues, labor and capital costs, and the number of full time equivalent and construction jobs.

Environmental benefits will be measured based on increases in the total amount of recycled materials produced. Using the U.S. Environmental Protection Agency's (EPA) WARM model, which estimates the greenhouse gas benefits of recycling various waste materials, the increase in recycling will be translated into an estimated greenhouse gas (GHG) reduction. Where the California Air Resources Board (ARB) has made modifications to the WARM model, the ARB measurements will be used. Greenhouse gas reductions will then be monetized based on economic estimates of the cost of each additional ton of GHG emissions. Only projects that increase the amount of recycled materials produced and generate sufficient environmental benefits will be eligible (e.g., replacing an existing piece of equipment with a similar new piece of equipment would likely not qualify).

Increases in recycling due to the STE will be estimated by taking applicant provided information about total production costs, tons of materials processed, and amount of recycled materials to be produced and calculating:

- the change in production costs due to the STE,
- the resulting increase in recycling due to the incentive effect of the STE based on supply and demand characteristics of the relevant recycling market,
- the reduction in GHG emissions from the EPA WARM model (or ARB), and
- the economic benefit from the reduction in GHGs.

For more information regarding application evaluation, see regulations Section 10033.

Other Proposed Modifications to the Regulations

Below is a brief summary of the key changes made in the proposed regulations, with section references. The full text of the proposed regulations can be found on the [CAEATFA website](#).

Biofuels

The proposed amendments to the regulations revise the evaluation criteria for Biofuel projects as defined in Section 10031(i) in order to simplify the application process and more accurately score fiscal benefits based on lessons learned. Because Biofuels will be distinguished from other

Alternative Sources, the proposed regulations define Biofuels, which will include biodiesel and biogas as defined in Sections 95481(a)(6) and 95481(a)(9) of Division 3 of Title 17 of the California Code of Regulations.

Fiscal Benefits

Part of the fiscal benefits analysis includes the estimated sales tax paid by consumers of the product produced by the project. However, some Biofuel applicants use the product produced and therefore are not paying a sales tax on a purchase that would otherwise be made externally. For example, a landfill that generates biofuel and uses that fuel to power its trucks will actually reduce sales taxes since it no longer buys (taxable) diesel fuel that it would previously have used. The proposed regulations add a couple of new questions to the application, data items, and scoring adjustments to proportionally reduce estimated sales tax revenue from the qualified product. See Section 10033(c)(1).

Environmental Benefits

Currently, the environmental effects of alternative source projects are measured and scored based on the energy generation potential of the project, which results in a reduction in the amount of non-alternative source power that otherwise would be needed. Applicants must calculate and provide the energy generation capacity of the project, and a dollar value of the pollution that is avoided per megawatt hour of electricity generation is assigned based on available research and analysis.

Under the proposed regulations, Biofuel applicants will instead provide the type of biofuel produced and units of energy produced, and the application workbook will use ARB estimates to calculate the net difference in greenhouse gas emissions between the various Biofuels and the corresponding fossil fuel and assign a dollar value to the reduction in pollution based on available research and analysis. See section 10033(c)(3).

Streamlining

As well as simplifying the application requirements for Biofuel projects, the proposed amendments to the regulations further streamline the application process by removing several questions from the Application Part B that are either redundant or have never been used to approve an applicant in the past.

Redundant Inputs

The current regulations require applicants to provide estimated facility sales and income tax liability. The proposed regulations remove these specific input requirements from the Application Part B because applicants already provide different information from which these parameters may be calculated. Applicants must provide the estimated number of units produced and sales price, which may be used to estimate facility sales. Additionally, the estimated facility sales, applicant-provided inputs on costs of goods sold, and specific assumptions established by the Executive Director based on information from the California Franchise Tax Board and other relevant sources, may be used to estimate income tax liability. See Section 10032(c)(4).

Unused Inputs

Current regulations allow AS and AT applicants to potentially earn supplemental points for substantial improvements in use of energy or water, or in avoided pollution or waste relative to comparable production processes if the applicant is able to provide substantial third party evidence. Any points awarded are not applied to fiscal or environmental benefits scores, but may be used to increase the total points earned, thus potentially allowing the applicant to meet the minimum scoring threshold required for Staff recommendation if the project's fiscal and environmental benefits are insufficient to meet that threshold. To date, no applicant has used the process improvement points to meet the minimum scoring threshold; therefore, the proposed regulations remove this section from the application. See Section 10032(c)(4)(F)(ii).

Additionally, the proposed amendments remove the requirement that applicants provide a NAICS code because Staff does not use NAICS codes to categorize applications but rather project type, which is more informative for tracking purposes as opposed to applicant-provided NAICS code. See Section 10032(c)(4)(D)(i).

Qualified Property Information

Part B of the application collects information about anticipated equipment purchases for the project. Applicants are asked to record information including a description of the equipment and its purpose in the manufacturing process, the estimated cost, the average lifespan, and percent of time it will be utilized in the qualifying process or to manufacture qualified products. Currently, applicants may lump together equipment valued at less than \$10,000, so long as the total value does not exceed \$100,000 and the individual items are reasonably related.

The proposed regulations will remove the \$10,000 limit for individual pieces of equipment and the \$100,000 cumulative cost limit. Program experience has shown that separating out projected equipment purchases based on a \$10,000 individual and \$100,000 cumulative cost basis can be difficult and sometimes unreliable. Applicants will still be allowed to group purchases as long as they are reasonably related. This will allow staff to review and inquire about the types of equipment necessary to complete the project prior to approval by the Authority. Additionally, all applicants are required to fill out a revised list of equipment purchases at the end of the project, which is easier and more accurate. As long as applicants group purchases in the application according to reasonably related categories, staff can do its due diligence, while relying on the back-end analysis to capture more detailed purchasing information. See Section 10032(c)(4)(C).

Environmental Benefits Scoring Threshold

Current regulations set the environmental benefits threshold for applications at 100 points for AS and AT, and 20 points for AM. This different threshold requirements are due to the fact that AM projects generally generate fewer environmental benefits through manufacturing process improvements than AS and AT projects do through products that directly generate environmental benefits. In reviewing sample applications, it was noted that AB 199 eligible projects create environment benefits that meet different quantifiable standards. To better accommodate the

variety of projects eligible under the Program, the 100 point threshold is decreased to 20 points for all projects. See Section 10033(c)(6).

Competitive Process

Current regulations stipulate that CAEATFA evaluate applications on a first-come-first-served basis. However, in light of the Program's historic oversubscription, questions have been raised as to whether this method of allocating awards provides the greatest possible benefit to the state. Instituting a competitive process when the Program cap is oversubscribed will rank projects by objective criteria that are verifiable at the time of application, rather than by order of submission, thereby maximizing the effectiveness of the Program in achieving its goals. See Section 10032(a)(7).

Applications will still be considered first-come, first-served, to best meet the needs of business cycles. At the time of oversubscription, all applications to be considered in the same month will be ranked based on four basic criteria; unemployment rate in the county of the facility, presence of corporate headquarters in California, status as a small business, and being new to the Program. Each criterion shall be worth between one and five points, and the application with the greatest point score shall be advanced first. In the event of a tie, the project with the smaller STE request will advance first. If the amounts of each request are identical, the order will be determined by the order in which the applications were received by CAEATFA. Additional applications will be advanced in the order of their rank, as the Program cap allows. The application that exceeds the Program cap will be the last application to be considered, with the portion of the award in excess of the cap being awarded from the next calendar year. All subsequent applications will be placed on a waiting list and considered in the following calendar year.

Unemployment Rate

If the Project is located in a county with an unemployment rate greater than 110% of the statewide average, the Project shall receive points based on the ratio of the local unemployment rate (Local Rate) to the Highest Unemployment Rate In the State (HUIS), pursuant to the following equation:

$$1 + ((\text{Local Rate} / \text{HUIS}) * 4)$$

Based on this formula, a project locating in the county with the highest unemployment rate in the state will receive five points, the maximum amount available. All other projects located in counties that exceed 110% of the statewide average for unemployment will receive at least one point, plus a fraction of the four possible points remaining. All rates will be based on those most recently reported by the California Employment Development Department at the time of application submission.

In the event that an applicant changes the location of the Project after approval, such that its ranking in the competitive process would have been adversely affected, the award shall be rescinded and granted to the next applicant in line. See Section 10032(a)(7)(B)(i).

Corporate Headquarters

Applicants with a corporate headquarters in California shall receive one point, as long as any parent company with an ownership interest greater than 50% also have a corporate headquarters in California. See Section 10032(a)(7)(B)(ii).

Small Business

If the applicant is classified as small businesses under U.S. Small Business Administration guidelines (Title 13 of the Code of Federal Regulations) and has fewer than 500 employees, the Project shall receive one point, provided that any parent company with an ownership interest greater than 50% is also classified as a small business. See Section 10032(a)(7)(B)(iii).

New Participant

If the applicant has not previously been approved for an award by the Authority, the Project shall receive five points, provided that, if the applicant has a parent company with an ownership interest greater than 50%, neither the parent company, nor its subsidiaries or affiliates have been previously approved for an award by the Authority. See Section 10032(a)(7)(B)(iv).

Project Caps

In addition to the competitive process, proposed modifications will add individual project caps to ensure a more equitable dispersion of awards. Each project will be limited to \$20 million of STE, calculated based on the statewide average sales tax at time of application. If additional funds are available at the end of the calendar year, approved applicants requesting more than the \$20 million cap will bring a revised application before the Authority in December of the same calendar year in which the original application was approved. The amount of additional STE available to each applicant will be determined by the Executive Director, calculated by taking the unawarded STE for that calendar year and dividing it evenly between all Projects that wish to exceed the \$20 million cap. See Section 10032(a)(4).

Purchase Requirement

To ensure that projects that apply are truly ready and will move forward, CAEATFA is requiring that 15% of the equipment be purchased within one year of approval by the Authority. There shall be no provision for a waiver, and applicants who do not meet this requirement will be subject to termination of the award. See Section 10035(b)(1).

Suspension

Approved applicants are required to adhere to terms and conditions laid out in statute, regulations, and the terms of the Master Agreement. Failure to comply with any of these may currently result in punitive measures such as audits or termination of the award. Proposed modifications would create an additional tool to help ensure compliance with Program guidelines, without resorting to more drastic measures. If the Applicant violates statute, regulations, or the terms of the Regulatory Agreement, the Executive Director may suspend the

Regulatory Agreement until the Executive Director certifies that the Applicant is once again in compliance. Purchases made during this suspension will not be excluded from the imposition of sales and use tax. See Section 10035(b)(8).

Fees

The current fee structure is intended to offset the costs associated with the review of applications (application fee) and the ongoing administrative needs of the Program (administrative fee). These fees do not cover the additional expense of bringing an approved applicant back before the Board for modifications to an existing Master Agreement. Proposed modifications will add two fee provisions to address this issue. The first provision adds a \$500 fee for any applicant that requests a modification of its existing Master Agreement requiring approval by the Authority. The fee is intended to offset standard costs for staff and materials necessary to bring a resolution before the Board. The second provision adds a fee for any applicant that requests a modification to its Master Agreement or authorizing resolution that requires a revised application to be considered by the Authority. The fee will be calculated by taking .00005 (one two hundredth of one percent) of the total amount of Qualified Property identified in the Authority resolution approved by the board, subject to a \$500 minimum and a \$2,000 maximum. See Section 10036(c)