Senate Bill 468

Tax Expenditures

Senator Hannah-Beth Jackson

Summary

SB 468 will bring transparency and accountability to California's tax incentive process by creating a mechanism for review of some of California's most costly tax expenditures. This will allow the Legislature, prior to deciding whether to renew them, to determine if they are cost-effective, properly designed and effecting their intended public policy objectives.

Background

California has nearly 80 tax expenditures. These are provisions in the tax code – including tax credits, tax deductions, sales tax exemptions and income exclusions – that reduce the amount of tax collected in exchange for an intended public policy objective. Many tax expenditures were created decades ago to achieve certain goals and economic benefits such as improving industry competitiveness, influencing taxpayer behavior or spurring economic growth, but have sat on the books for decades without any scrutiny, oversight, or necessary data to demonstrate results.

These tax expenditures carry significant costs to the state of California in the same manner as spending programs. They impact the General Fund as well as Proposition 98, the minimum annual funding level for K-12 schools and community colleges. The Department of Finance indicates that by 2020-21, there will be a $506.4 billion loss in revenue to the General Fund since 2008 from tax expenditures. Every dollar of a tax credit that does not generate its cost in new revenue takes approximately 40 cents out of California's classrooms and additionally affects the amount of funding available for critical public services.

In 2014, SB 1335 (Leno) was enacted into law, requiring that every new tax credit contain specific performance measurement standards. Unfortunately, this law contained no mechanism for applying this accountability to previously enacted tax expenditures.

Currently, the Department of Finance publishes an annual report on tax expenditures and provides it to the Legislature.

While this report describes each tax expenditure, its statutory origin and costs, it does not provide the necessary data or rigorous analysis needed to evaluate the expenditures' impact and benefits to California. According to a report by the Pew Charitable Trusts, California is trailing other states because it has not adopted a plan for regular evaluation of tax incentives.

Prior experience demonstrates the value of data and analysis for spurring improvements to tax incentives. In 2013, lawmakers determined that the state's Enterprise Zone Program, which cost the state an estimated $750 million in 2014, was not performing as intended. In response to a series of studies showing the program was failing to generate jobs, lawmakers ended the Enterprise Zone Program and redirected funding to three new incentives.

In a 2015 audit of Corporate Income Tax Expenditures, the California State Auditor concluded that "Adopting oversight methods used by other states would improve the effectiveness of the State's current and future tax expenditures, providing the Legislature with more information and a better accounting of the effectiveness and impact of these tax expenditures. These practices include the use of clearly stated policy objectives to define the Legislature's intent in enacting the tax expenditures, corresponding performance measures, sunset provisions to prompt legislative review and to create the ability to more easily modify or repeal them if needed, and an evaluation process that creates recommendations that tie back to the Legislature's policymaking process. By consistently following these best practices, existing tax expenditures could be improved while simultaneously reducing the risk of creating new ineffective incentives."

SOLUTION -- SB 468

As proposed to be amended, SB 468 will begin the process of examining some of California's largest tax expenditures to evaluate whether they are achieving their goals. This bill chooses among the largest of the expenditures among the tax credits and sales tax exemptions that have no metrics of efficacy associated with them, no sunsetting provision, and result in revenue losses of greater than $1 billion each over 10 years. These are:

- Water's edge election
- Research and Development (R & D) Credit
- Sales tax exemption for meat & fish, feed and drugs for such animals; seeds and plants used for human food, fertilizer for such plants
- Like-kind exchanges of investment property
- Subchapter S corporation election
- Airline fuel for international flights
- Sales tax exemption for farm machinery
- Deduction for dividends paid to Employee Stock Owernship Plans
- Exclusion of sales tax on sales of custom computer programs

The bill sunsets these provisions in three years and directs the Legislative Analyst's Office to analyze each for its effectiveness prior to the sunset. It also requires that when and if the expenditures are renewed, the renewal language include the goals of the tax expenditure and metrics for evaluating its effectiveness.

This bill is intended to be the beginning of a process whereby California examines all of its tax expenditures to assure they are achieving their public policy objectives and making best use of limited public dollars.

SUPPORT

California Teachers Association (co-sponsor)
California Tax Reform Association (co-sponsor)

STATUS

To be heard in Senate Governance and Finance on May 1.

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