ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Ridley-Thomas	Analyst:	Rachel Coco	Bill Number:	AB 2106
Related Bills:	See Legislative History	Telephone:	845-4328	Amended Date:	May 17, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: California Tax Expenditure Accountability Act/Tax Expenditures Report

SUMMARY

This bill would require the Department of Finance (DOF) and the Legislative Analyst's Office (LAO) to submit reports on tax expenditures to the Legislature.

SUMMARY OF AMENDMENTS

The May 17, 2004, amendments removed legislative intent language. In addition, the amendments repealed an existing provision that requires DOF to provide an annual tax expenditure report and added language that would require several reports to the Legislature regarding tax expenditures currently in effect. The amendments would add criteria to be included in new legislation relating to tax expenditures.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to establish a reporting system in order to evaluate the effectiveness of tax expenditures.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2005. However, the bill states that DOF shall make its first report to the Legislature on or before September 15, 2005. In addition, the bill specifies that LAO's first report would be due on or before October 1, 2005.

POSITION

Pending.

ANALYSIS

STATE LAW

State law requires all state agencies to submit to the Governor a complete plan and itemized statement of all proposed expenditures and estimated revenues for the ensuing fiscal year. Included is a comparison of each item of revenues and expenditures with the actual revenues and expenditures for the last completed fiscal year. The Governor is required to submit a budget within the first 10 days of the regular session of the Legislature. The Governor's budget is developed using the state agency reports described above.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Gerald H. Goldberg	6/1/04
______ SA	______ O	______ NAR		
______ N	______ OUA	__X__ PENDING		

THIS BILL

This bill would repeal an existing provision that requires DOF to provide an annual report to the Legislature on tax expenditures containing specified information.

This bill would create a new provision to require DOF to submit to the Legislature a report on tax expenditures currently in effect, including those under the Personal Income Tax Law, the Corporation Tax Law, and the Sales and Use Tax Law. The report would be required to contain the following, to the extent feasible:

- a description of each tax expenditure,
- the statutory or legal authority for each tax expenditure,
- the original intent of each tax expenditure, and
- an estimate of revenue loss for the most recent fiscal year for each tax expenditure.

In addition, DOF would be required to include information in the report, based on information provided by the Franchise Tax Board (FTB), regarding tax expenditures that are separately identified on returns or claims, to the extent feasible. Specifically:

- the number of tax returns or taxpayers affected by the tax expenditure and
- the distribution of each tax expenditure, as follows:
    - for expenditures available to businesses, by size of the business or industry, by size of total receipts, and by type of business or industry, and
    - for expenditures under the PITL, by adjusted gross income brackets.

This bill also would require LAO to submit to the Senate and Assembly Revenue and Taxation Committees a report containing:

- a summary of any available findings or information regarding the effectiveness of any tax expenditure, and
- the conditions under which individual tax expenditures should be viewed as a successful policy tool.

This bill would require DOF to provide its first tax expenditure report to the Legislature on or before September 15, 2005. LAO would be required to provide its first tax expenditure report to the Legislature on or before October 1, 2005. The reports would then be required in each odd-numbered year thereafter. However, the bill also states that the reports would be provided in even-numbered years, but may be limited to new or revised tax expenditures and to significant updates, revisions, or corrections of information in the prior year’s report.

This bill would require the Senate and Assembly Revenue and Taxation Committees to review the reports submitted by DOF and LAO. Upon review, the committees would be required to conduct annual interim hearings to:

- make recommendations to the Joint Legislative Budget Committee for tax expenditures that should be reviewed and evaluated in the upcoming budget.
- introduce legislation to adopt specific goals, information requirements, and evaluation studies for selected existing tax expenditures that are currently lacking them.

Based on the recommendations made by the Revenue and Taxation Committees, the Joint Legislative Budget Committee would direct the Legislative Analyst to evaluate selected tax expenditures and make recommendations to the budget committees during the budget process.

Under this bill, the Senate Committee on Budget and Fiscal Review and the Assembly Committee on Budget would be required to consider the Legislative Analyst's report in conjunction with each committee's consideration of the annual Budget Act. The committees would evaluate the priority of each tax expenditure as compared with all other state expenditures. The committees' evaluation would include the following criteria:

- the extent to which the tax expenditure is a successful policy tool.
- the cost-effectiveness of the tax expenditure.
- potential policy alternatives for achieving the policy goals of the tax expenditures.
- the feasibility of repealing or continuing each tax expenditure.

This bill also would require any legislation establishing new tax expenditures or extending existing ones, to include:

- a sunset provision,
- a requirement for an evaluation study that may include submission of information by taxpayers benefiting from the tax expenditure,
- recapture provisions if a taxpayer fails to meet any commitments that are required to qualify for the tax benefit, and
- measurable goals or objectives.

IMPLEMENTATION CONSIDERATIONS

It is unclear what is intended by the phrase "size of the business or industry." The term "size" could be determined using varying criteria. For instance, size could mean total number of employees, total income, or even gross receipts. Thus, the department would need to make assumptions regarding the size of business, which may or may not reflect the author's intent.

FTB's "distributional information" is based on a tax-year basis, but the "revenue impacts" as required by this bill would be on a fiscal-year basis. Therefore, FTB would be required to create an additional report. Thus, implementing this bill would have a minor impact on the department.

LEGISLATIVE HISTORY

AB 990 (Ridley-Thomas, 2003/2004) would require DOF to submit to the Legislature a report on tax expenditures. AB 990 is currently in the Senate Revenue and Taxation Committee.

SB 1292 (Haynes, 2001/2002) would have required state agencies, boards, commissions, departments, and offices to provide a report regarding financial activities to specific legislative committees for the 2001/2002 fiscal years and preceding fiscal years. This bill failed to pass out of the house of origin.

OTHER STATES' INFORMATION

The states reviewed include *Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These state were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, *Michigan*, and *New York* require a tax expenditure report, similar to the reports proposed by this bill, to be submitted by the respective Governor of each state to the Legislature every year. There was no information available for *Massachusetts*.

Minnesota requires the commissioner of revenue to prepare a tax expenditure budget report for the state. The report contains the amount of tax revenue foregone for each tax expenditure, the legal authority for each tax expenditure, and the year in which each was enacted. The report is submitted to the Legislature by February 1 of each even-numbered year.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would not impact the state's income tax revenue.

LEGISLATIVE STAFF CONTACT

Rachel Coco
Franchise Tax Board
845-4328
rachel.coco@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov