

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Arambula Analyst: Rachel Coco Bill Number: AB 735

Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 17, 2005

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: FTB Assist Legislative Analyst With Report On Tax Exceptions

SUMMARY

This bill would require the Legislative Analyst's Office (LAO) to prepare a report on tax exceptions.

PURPOSE OF THE BILL

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

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2006.

POSITION

Pending.

ANALYSIS

STATE LAW

Current state law requires the Department of Finance (DOF) to provide an annual report to the Legislature on tax expenditures, including tax credits, deductions, exclusions, and exemptions. This report must provide details on individual categories of the expenditures and historical information on the enactment and repeal of the expenditures.

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.

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:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

3/8/05

THIS BILL

This bill would require LAO to establish a process to review all tax exceptions, as defined, and submit a report to the Legislature on the tax exception review process on or before December 31, 2006. The review must include the following:

- A fiscal and economic analysis that considers the original social and economic purpose of each tax exception.
- A discussion and examination of the minimal level necessary for each tax exception to achieve the state's objective.
- An evaluation of income groups benefiting by each tax exception, the distribution of benefits among income groups, and the effect of each tax exception on the overall distribution of tax burden.
- A discussion of the extent to which any federal and state tax exceptions may overlap.

If any of the information required above is not available, LAO would be required to include a reason why the information is missing and what is needed to make it available.

The bill defines "tax exceptions" as various tax exclusions, exemptions, credits, and deferrals, and preferential tax rates that reduce the amount of revenue collected from the state's basic tax structure.

LAO would be required to review and analyze any relevant reports prepared by the DOF and request assistance from the Franchise Tax Board and the Board of Equalization to make the report on tax exceptions as comprehensive as possible.

Once the tax exceptions have been identified, LAO would be required to provide the legislature a thorough analysis of each tax exception on or before December 31 of each even-numbered year. The report would discuss the identified tax exceptions to which any of the following applies:

- The exception provides windfall benefits to individuals or groups whose behavior is unaffected by the tax incentive.
- The exception works contrary to the objectives of other state programs or other tax exceptions.
- The exception is no longer consistent with the original goals and objectives for which it was intended.
- The exception has little or no clear economic or social justification.
- The exception benefits primarily only a clearly identifiable single economic entity or a very small special interest group.

The report would also be required to contain an estimate of the rate of growth of the total amount of tax exceptions over the previous year and identify those tax exceptions that are growing at rates in excess of the growth rate of the General Fund budget.

The bill would require the Senate and Assembly Revenue and Taxation Committees to review the report and would authorize them to select a group of tax exceptions for special review. The committees could recommend tax exceptions from that group for deletion or modification and would provide their recommendation to the fiscal committees for consideration during the budget process.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department.

LEGISLATIVE HISTORY

AB 168 (Ridley-Thomas, 04/05) would require DOF to submit a report on tax expenditures to the Legislature. AB 168 is currently in the Assembly Revenue and Taxation Committee.

AB 2106 and AB 990 (Ridley-Thomas, 03/04) would have also required DOF to submit a report on tax expenditures to the Legislature. AB 2106 was vetoed by Governor Schwarzenegger. The veto message stated that it would be difficult for DOF to report some of the information required by AB 2106 since much of it is unavailable. AB 990 failed to pass out of the Legislature by the constitutional deadline.

SB 1292 (Haynes, 01/02) 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. SB 1292 failed to pass out of the house of origin by the constitutional deadline.

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.

Research found that *Illinois*, *Michigan*, *Minnesota*, and *New York* all require tax expenditure reports to be submitted to the Legislature. However, it does not appear that any reports similar to the one that would be required by this bill are submitted. There was no information available for *Massachusetts*.

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

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