
SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
2025 - 2026 Regular

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Fiscal: Yes

TAXATION: TAX EXPENDITURES: CALIFORNIA TAX EXPENDITURE REVIEW BOARD

Directs LAO to write and publish a report that comprehensively assesses the state's major tax expenditures and make recommendations to the Legislature based on the report.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something they would otherwise not do, but for the tax credit. The Department of Finance (DOF) is required to annually publish a list of tax expenditures, which currently total around \$94.2 billion per year.¹

Many of California's most significant tax expenditures contain sunset dates, including, among others:

- The Television and Motion Picture Production Credit, administered by the California Film Commission, which DOF estimates results in \$141 million in foregone revenue in 2023-24, growing to \$463 million in 2027-28. The Legislature increased the authorization amount from \$330 million to \$750 million last year, among other changes (AB 1138, Zbur, and SB 132, Committee on Budget & Fiscal Review).
- The California Competes Tax Credit, administered by the California Competes Tax Credit Committee, which DOF estimates results in \$6 million in foregone revenue in 2023-24, growing to \$12 million in 2027-28. While the program is set to sunset after the 2027-28 fiscal year, both Governor Newsom's 2026-27 Proposed Budget and SB 1120 (McNerney) would extend the program by five years.
- The State General Fund-only sales and use tax exemption on purchases of manufacturing equipment made by taxpayers within specific North American Industrial Classification System codes, capped at \$200 million annually per taxpayer. In 2017, the Legislature expanded and extended this exemption until January 1, 2030, as part of legislation to extend the Global Warming Solutions Act (AB 398, E. Garcia, 2017).

While the Legislature has extended sunsets for several tax expenditures like those noted above, they occasionally sunset and are repealed. Last year, the New Employment Credit, which

¹ <https://dof.ca.gov/media/docs/forecasting/revenue-and-taxation/tax-expenditure-reports/2025-26-Tax-Expenditure-Report.pdf>

directed the Franchise Tax Board (FTB) to allocate credits for wages paid by taxpayers to qualified employees within areas that suffer from high levels of poverty and unemployment, sunset and 2025 was the last taxable year the credit could be claimed. However, AB 2205 (Quirk-Silva), currently pending in the Assembly, would reinstate the credit.

Additionally, the Legislature often requires the Legislative Analyst's Office (LAO) to analyze specific aspects of new or extended tax expenditure programs and report to the Legislature, usually one year before its sunset date. The Legislature applied these requirements to the Motion Picture Production Credit and the California Competes Tax Credit, among others. Additionally, FTB publishes several reports regarding specific tax credits.²

Many of the state's tax expenditures that result in the most foregone revenue do not have sunset dates, some of which fully or partially conform with provisions of the Internal Revenue Code:

- Personal Income Tax (PIT) exclusion for employer pension contributions, which DOF estimates results in \$15 billion in foregone revenue in 2023-24, growing to \$22 billion in 2027-28.
- PIT exclusion for employer contributions to health plans (\$9.5 to \$10 billion).
- PIT exclusion for social security benefits (\$5 to \$6 billion).
- Sales tax exemption for food products (\$5 to \$5.5 billion state/\$6.2 to \$6.8 billion local).
- Basis step-up on inherited property (\$4.5 to \$5.5 billion).
- PIT exclusion for capital gains for primary place of residence (\$4 to \$5 billion).
- PIT deduction for charitable contributions (\$3.5 to \$4.1 billion).
- Water's edge election for Corporation Tax purposes (\$3.4 to \$4.5 billion).³
- Sales tax exemption for prescription drugs (\$2.5 billion state/\$3.1 billion local).
- PIT deduction for mortgage interest (\$3 billion).
- PIT deduction for real estate, property, and other taxes (\$3 billion).
- Research and Development Credit under PIT and Corporation Tax (\$2.2 - \$3.4 billion).
- Like-kind exchanges under PIT and Corporation Tax (\$1.5 billion).

Credit Limitation. In 2024, the Legislature limited the total of all business credits, with some exceptions, including credit carry forwards, to \$5,000,000 in the 2024, 2025, and 2026 taxable years, unless the Director of Finance determines that General Fund money over the multiyear forecast is sufficient *without* the revenue impact of the net operating loss suspension and credit limitation (SB 167 and SB 175, Committee on Budget & Fiscal Review). Taxpayers can make an irrevocable election to receive an annual refundable credit claimed in future tax years for business credits equal to credit amounts not claimed due to the limitation.

Section 41. In 2014, Governor Brown signed SB 1335 (Leno), which added Section 41 to the Revenue and Taxation Code. In the hopes of applying the same level of review used for government spending programs to tax expenditure programs, including tax credits, Section 41 requires any bill introduced on or after January 1, 2015, that allows a new income tax credit to contain specific goals, purposes, and objectives that the tax credit will achieve. In addition, Section 41 requires detailed performance indicators for the Legislature to use when measuring

² <https://www.ftb.ca.gov/about-ftb/data-reports-plans/index.html>

³ The Committee held a joint information hearing with the Assembly Revenue & Taxation Committee regarding the water's edge election on February 11, 2026. Agenda and hearing materials can be found here: <https://srev.senate.ca.gov/2023-24-hearings/2026-informationaloversight-hearings>

whether the tax credit meets its goals, purposes, and objectives. The Legislature expanded Section 41 to include all tax expenditures under the Personal Income and Corporation Taxes, as well as sales and use tax exemptions (AB 263, Burke, 2019), but not PIT exclusions when there is no available data to collect (AB 3289, Committee on Revenue and Taxation, 2024).

With the state's ongoing fiscal challenges squeezing resources available to fund public education, among other programs, advocates for teachers and public employees want LAO to review the state's major tax expenditures and make recommendations for changes.

Proposed Law

Senate Bill 1349 directs LAO to write and publish a report that comprehensively assesses the state's major tax expenditures and make recommendations to the Legislature based on the report by January 1, 2029. As part of the comprehensive assessment, LAO must identify any savings that the Legislature can reduce or eliminate from the major tax expenditures, and can consider the following criteria when finalizing the report:

- General Fund impact.
- LAO's assessment of whether modification or repeal of the major tax expenditure would provide the most positive impacts on the General Fund with the least negative economic, social, or environmental impacts.

The bill directs any other state agency to assist LAO with completing its comprehensive assessments of major tax expenditures to the maximum degree practicable.

The measure provides that the scope of each comprehensive assessment must include, to the extent possible:

- A description of the legislative intent for each tax expenditure, if the act adding or amending the tax expenditure contains legislative findings and declarations of that intent or that legislative intent is otherwise expressed or specified by that act.
- A brief description of the beneficiaries of the tax expenditure, as provided by state law.
- The number of returns filed or business entities affected, as applicable, for the most recent tax year for which full-year data is available.
- A listing of any comparable federal tax benefit, if any.
- A description of any recent prior tax expenditure evaluation or compilation of information completed by any state agency.
- The economic, social, or any other benefits of the tax expenditure to the State of California.
- The total net General Fund money lost due to the tax expenditure, including the impact that the shift in resources has on other General Fund programs.
- The total reduction in the amount of General Fund proceeds from taxes for purposes of the Proposition 98 guarantee due to the tax expenditure, including the impact the shift in resources has on educational programs.
- The potential environmental impacts of the tax expenditure, if any.
- A long-term analysis outlining the true beneficiaries versus intended beneficiaries of the tax expenditure, and its impact on the business climate and market conditions.
- Jobs created by the tax expenditure, including all of the following additional information:

- Whether the jobs created were short- or long-term positions, as well as the average salary and benefits provided for the jobs created.
- The number of jobs lost or reduced in areas impacted by the tax expenditure, or whether jobs were shifted to other sectors.
- Aggregate demographics on gender, race, ethnicity, and age for the jobs created.

LAO's recommendation must include the following:

- The extent to which each major tax expenditure is a cost-effective use of resources compared to other options to address the same purpose, intent, or goal.
- An analysis of each major tax expenditure's effect on the General Fund.
- An analysis of each major tax expenditure's effect on employment, wages, and the state's economy.
- Whether opportunities exist to improve the effectiveness of each major tax expenditure in meeting its purpose, intent, or goal, or if no such opportunities exist, whether the Legislature should enact legislation to repeal each major tax expenditure.

The bill defines "major tax expenditure" using the same definition as the DOF tax expenditure report, with the following modifications:

- The amount of foregone revenue resulting from the tax expenditure is equal to or greater than one billion dollars over the previous 10 fiscal years.
- Does not contain either a repeal or inoperative date, or a requirement to report any metrics of efficacy.

The bill then excludes the following from the definition of "major tax expenditure":

- Sales and use tax exemptions for:
 - Gas, electricity, and water, including steam and geothermal steam, brines, and heat, when delivered to consumers through mains, lines, or pipes.
 - Liquefied petroleum gas, delivered to a qualified residence by the seller, that is sold for household use in the qualified residence, or liquefied petroleum gas that is purchased for use by a qualified person to be used in producing and harvesting agricultural products.
 - Water, when sold to an individual in bulk quantities of 50 gallons or more, for general household use in his or her residence if the residence is located in an area not serviced by mains, lines, or pipes.
 - Exhaust steam, waste steam, heat, or resultant energy, produced in connection with cogeneration technology.
 - Food products for human consumption.
 - Prescription medication.
 - Hemodialysis products supplied to a patient on order of a licensed physician and surgeon.
- Is not solely allowed against the Personal Income Tax.
- Public safety officer death benefits.
- Tax exempt status for non-profit organizations.
- Charitable contribution deductions.
- Payments from life insurance contracts, endowments, or other annuity contracts.

LAO must submit the report to the Assembly and Senate Committees on Revenue & Taxation, and publish the report on its website. The bill requires the Committees to hold a joint public hearing on the report by August 15th of the second year of the Legislative session. The bill also makes legislative findings and declarations supporting its purposes. The bill makes its provisions inoperative on the date six months following the joint hearing of the Assembly and Senate Revenue & Taxation Committees and repeals its provisions the following January 1st.

State Revenue Impact

No estimate.

Comments

1. **Purpose of the bill.** According to the author, “California has over 100 tax expenditures that resulted in a \$94 billion loss in general fund revenues in fiscal year 2025-26. Because programs established before 2014 lack modern performance standards, a 2016 State Auditor’s report found insufficient evidence that they are actually meeting their goals. This assessment of California’s largest corporate tax expenditures introduces long-overdue oversight into the use of taxpayer dollars. By providing a clear, data-driven report, SB 1349 will chart a path for California to invest its resources more effectively and accountably.”

2. **Necessary?** California does not lack publicly available aggregate information about its tax expenditures. In addition to the reports referenced above, the California Department of Tax and Fee Administration (CDTFA) issues Publication 61, which details all sales and use tax exemptions. In its recent report “Comparing Options to Raise and Lower Taxes,” LAO included several options to modify current tax expenditures, among other changes to state taxation.⁴ The Legislature has already required LAO to complete eleven reports on recently enacted bills by the end of the decade. SB 1349 would place additional demands on LAO to produce a report where plenty of publicly available information already exists, and which LAO may not be able to complete with its current resources by the bill’s deadline.

3. **Tax expenditure reviews.** In June 2017, the Pew Charitable Trusts issued its report on “How States are Improving Tax Incentives for Jobs and Growth: A National Assessment of Evaluation Practices.” The report made three recommendations for states:

- *Make a plan.* Lawmakers need to put processes in place to regularly evaluate the results of major tax incentives. Well-designed evaluation plans ensure that the state’s full portfolio of incentives is examined, that nonpartisan staff with relevant expertise are tasked with the analyses, and that the reviews take place on a strategic schedule.
- *Measure the impact.* High-quality evaluations carefully assess the results of incentives for the state’s budget and economy. To do so, evaluators must estimate the extent to which incentives successfully changed business behavior, as opposed to rewarding what companies would have done anyway.
- *Inform policy choices.* Lawmakers and executive branch officials should use the findings of evaluations to improve the effectiveness of tax incentives. Policy improvements are more likely when states have a formal process that ensures lawmakers will consider the results, for example, by holding legislative hearings on evaluations.

⁴ https://lao.ca.gov/reports/2026/5170/Comparing_Options_to_Raise_and_Lower_Taxes_032426.pdf

The report added that 27 states and the District of Columbia have made progress in gathering evidence on the results of their economic development tax incentives in the last five years, and ten of these states are leaders in tax incentive evaluation. California was not included in either set; instead it was described as “trailing,” because it lacks a regular evaluation schedule. The report adds that as a result, California has studied some tax expenditures in detail, while ignoring others. Additionally, the report praised California for eliminating its enterprise zone program after a series of studies showed that the program was mostly moving jobs in the state without boosting net employment.

In April 2016, State Auditor Elaine Howle issued “Corporation Tax Expenditures: The State’s Regular Evaluation of Corporate Income Tax Expenditures Would Improve Their Efficiency and Effectiveness”. The report concluded that if California adopted oversight methods used by other states, it would improve the effectiveness of its current and future tax expenditures, provide the Legislature with more information, and better account for their effectiveness and impact. The Auditor specifically found that a lack of oversight and information regarding the R&D credit and the minimum franchise tax exemption has resulted in insufficient evidence to determine if they are fulfilling their purposes. The auditor added that three other tax expenditures—the water’s edge election, the low-income housing credit, and the film and television credit—appear to be achieving their purposes, but improvements would make them more effective.

4. Being specific. Applying SB 1349’s definition of “major tax expenditure,” LAO’s assessment would seem to include the following tax expenditures for review:

- The Water’s Edge Election.
- Research and Development Credit.
- Cable Companies Apportionment Exclusion.
- Basis step-up on inherited property.
- Like-Kind Exchanges.
- Sales and Use Tax exemptions for:
 - Animal Life, Feed, Seeds, Plants, and Fertilizer; as well as Drugs and Medicines administered to animals.
 - Candy, Confectionery, Snack Foods, and Bottled Water.
 - Meals Furnished by Institutions.
 - Farm Equipment and Machinery.
 - Fuel Sold to Common Carriers Exemption.

However, both the Cable Company Apportionment Exclusion and the Candy, Confectionary, Snack Foods, and Bottled Water exemptions were added by voter initiative (Proposition 39, 2012, and Proposition 163, 1992, respectively), and would likely require voter approval to amend or repeal.

5. The more things change. According to Stanley Surrey and Paul McDaniel’s “Tax Expenditures,” the United States Department of the Treasury first published a tax expenditure budget in 1968. The Congressional Budget Act of 1974 required that all future budgets detail the tax expenditure concept and provide a detailed account of federal tax expenditures in the federal budget. In 1976, Congress reduced tax expenditures as part of the Tax Reform Act. Soon after, President Jimmy Carter urged the Treasury to recommend whether tax expenditures could be repealed to reduce taxes overall, and Congress considered sunset reviews and statutory caps on federal spending. Currently, the Joint Committee on Taxation estimates that tax expenditures

resulted in \$1.8 trillion less federal revenue in 2024 – an amount equal to 6% of the national gross domestic product, or almost 40% of all federal annual revenues.

6. One-way ratchet. Under Section Three of Article XIII A of the California Constitution, added by Proposition 13 (1978) and most recently amended by Proposition 26 (2012), the Legislature can only change a state statute that results in any taxpayer paying a higher tax by 2/3 vote of each house. However, like any other form of spending short of a direct appropriation, the Legislature can enact a new tax expenditure by simple majority vote. As a result, the number and fiscal effect of tax expenditures has grown at the cost of General Fund revenue.

7. Related legislation, part one. In 2019, the Legislature approved, but Governor Newsom vetoed, SB 468 (Jackson), which would have created the California Tax Expenditure Review Board. The Board would have been tasked with determining the schedule for comprehensive assessments of major tax expenditure programs, which were to be conducted by a University of California research center. The Governor stated:

I support greater transparency with respect to tax credits, exemptions, and other expenditures and believe these items should be scrutinized periodically to justify their overall cost to the state's revenue base. ...creating a new board to accomplish that goal is unnecessary. The Department of Finance is currently required to publish tax expenditure reports and existing law requires new income tax expenditures to specify goals, performance indicators, and data collection requirements.

The Senate approved a very similar measure in 2020, SB 956 (Jackson), which was never heard in the Assembly.

8. Related legislation, part two. As noted above, there is no lack of aggregate data regarding the state's tax expenditures. However, taxpayer confidentiality laws bar tax agencies from disclosing any taxpayer-specific information that could be used to assess how specific companies and industries avail themselves of tax expenditures. SB 972 (Skinner) would have pierced those laws to direct FTB to compile a list of all taxpayers subject to the Corporation Tax with gross receipts of \$5 billion or more for the taxable year reported on a return submitted in the previous calendar year, its annual gross receipts, and the amount of credits it claimed, among other information. FTB would send the information to legislative tax committees. However, Governor Newsom vetoed that measure as well, stating:

This bill would require the Franchise Tax Board (FTB) to provide certain information about corporate tax filings to two legislative committees.

This bill is unnecessary, as current law already authorizes the FTB, upon request, to disclose taxpayer data to legislative committees. The committee, its officers and employees are required to maintain the confidentiality of the information provided.

I am not persuaded that enactment of this bill would provide additional value to future policy deliberations

10. Technical. Committee Staff recommends the following technical amendment:

- In new Revenue & Taxation Code 43(b), replace “reduce or eliminate” with “realize by reducing or limiting”.

Support and Opposition (4/6/26)

Support: California Teachers Association (Co-Sponsor)
American Federation of State, County and Municipal Employees, AFL-CIO
California Federation of Labor Unions, AFL-CIO
California State Association of Counties
California State Council of Service Employees International Union
League of California Cities
One Individual

Opposition: California Taxpayers Association

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