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THIRD READING

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Bill No: SB 1349  
Author: Gonzalez (D), et al.  
Amended: 4/28/26  
Vote: 21

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SENATE REVENUE AND TAXATION COMMITTEE: 4-1, 4/8/26  
AYES: McNerney, Ashby, Becker, Grayson  
NOES: Alvarado-Gil

SENATE APPROPRIATIONS COMMITTEE: 5-2, 5/14/26  
AYES: Cervantes, Cabaldon, Grayson, Richardson, Wahab  
NOES: Seyarto, Dahle

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**SUBJECT:** Taxation: tax expenditures: Legislative Analyst's Office:  
assessment, report, and recommendation

**SOURCE:** American Federation of State, County, and Municipal Employees  
California Teachers Association

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**DIGEST:** This bill directs the Legislative Analyst's Office (LAO) to comprehensively assess the state's major tax expenditures, as defined, issue a report, and make a recommendation to the Legislature.

**ANALYSIS:**

Existing law:

- 1) Allows various income tax credits, deductions, exemptions, and exclusions, among them:
  - a) The Research and Development Credit, calculated in partial conformity with federal law, that allows a credit against the Personal Income and Corporation Taxes for a taxpayer's qualified research expenses incurred in California that exceed the base year amount, as defined, plus a percentage of the amount

paid or incurred during the taxable year on research undertaken by a research consortium.

- b) Basis Step-Up on Inherited Property, in conformity with federal law, that “steps up” the basis of inherited property to fair market value as of the date of death under both the Personal Income and Corporation Taxes, so heirs do not pay taxes on gains from assets that appreciated in value when held by the decedent.
  - c) Like-Kind Exchanges, in modified conformity with federal law, that defers the recognition of any gain or loss under both the Personal Income and Corporation Taxes on the exchange of property held for productive use in a trade or business or for investment, if that property is exchanged solely for property of a like kind that is to be held either for productive use in a trade or business or for investment.
  - d) Expensing of Research Expenses, in conformity with federal law, where taxpayers can elect to either deduct research and experimental expenditures under both the Personal Income and Corporation Taxes in full the year they were paid or incurred, or elect to capitalize and amortize them over at least 60 months. A taxpayer that did not expense or capitalize and amortize these expenditures had to treat the costs as chargeable to a capital account.
- 2) Allows as an exception for qualified cable companies to the general requirement for multistate businesses to apportion net income to California for Corporation Tax purposes based on a factor equal to its California sales divided by its total sales. Qualified cable companies spending \$250 million or more in California on certain expenditures can exclude half of their in-state sales when apportioning (Proposition 39, 2012).
- 3) Permits taxpayers to either file on a worldwide combined reporting basis or to elect to calculate California income and activities on a water’s-edge basis. Generally, water’s-edge taxpayers may exclude income and apportionment factors of foreign-organized unitary affiliates that would otherwise be part of its unitary combined report, with some exceptions.

This bill:

- 1) Directs the Legislative Analyst’s Office to comprehensively assess the major tax expenditures of the state, write and publish a report on each major tax expenditure, and make a recommendation to the Legislature based on each report.

- 2) Defines “major tax expenditure” to include:
  - a) The Water’s Edge Election.
  - b) The Research and Development Tax Credit.
  - c) Basis Step-up on Inherited Property.
  - d) Like-Kind exchanges.
  - e) Expensing of Research Expenditures.
  - f) Special apportionment for qualified cable companies.
- 3) Requires LAO to identify any savings that the Legislature can realize by reducing or limiting the major tax expenditures as part of its assessments.
- 4) Directs LAO to consider the following criteria when finalizing each report:
  - a) The extent to which the major tax expenditure is a cost-effective use of resources compared to other options to address the same purpose, intent, or goal.
  - b) An analysis of the major tax expenditure’s effect on the General Fund, including Proposition 98.
  - c) An analysis of the major tax expenditure’s effect on employment, wages, and the state’s economy.
  - d) Whether opportunities exist to improve the effectiveness of the 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.
- 5) Requires LAO to complete and publish on its internet website its first report on a major tax expenditure by October 15, 2027, and thereafter, complete and publish on its internet website each subsequent report on a major tax expenditure annually, as determined by the office.
- 6) Directs the Senate and Assembly Committees on Revenue and Taxation to hold a joint public hearing on the assessment by August 15 of the second year of the legislative session in each legislative session in which LAO completes a comprehensive assessment of a major tax expenditure.

## Background

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.

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. However, many of California's most significant tax expenditures *do* 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 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, Governor Newsom's 2026-27 Proposed Budget 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.

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 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.

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.

*Section 41.* In 2014, Governor Brown signed SB 1335 (Leno, Chapter 845, Statutes of 2014), 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 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, Chapter 743, Statutes of 2019), but not PIT exclusions when there is no available data to collect (AB 3289, Committee on Revenue and Taxation, Chapter 124, Statutes of 2024).

**FISCAL EFFECT:** Appropriation: No Fiscal Com.: No Local: No

According to the Senate Appropriations Committee, this bill would result in a cost pressure to the LAO to perform its required workload (General Fund). The LAO could likely absorb this work, but by doing so, it would be less able to serve the Legislature in other capacities, such as fulfilling member requests and providing technical assistance. The LAO's funding comes the Legislature's budget, which is capped by Proposition 140 (1990). Thus, to the extent the Legislature provides additional funding to the LAO to perform the duties required by the bill, less resources would be available for the remainder of its budget.

**SUPPORT:** (Verified 5/16/26)

American Federation of State, County and Municipal Employees, AFL-CIO (Co-Source)

California Teachers Association (Co-Source)

California Federation of Labor Unions, AFL-CIO

California Federation of Teachers

California Professional Firefighters

California School Employees Association

California State Association of Counties

California State Council of Service Employees International Union

City of Thousand Oaks

League of California Cities  
Los Angeles Unified School District  
One individual

**OPPOSITION:** (Verified 5/16/26)

California Chamber of Commerce  
California Taxpayers Association

**ARGUMENTS IN SUPPORT:** 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.”

**ARGUMENTS IN OPPOSITION:** According to the California Taxpayers Association, “We are concerned that SB 1349 would create an unnecessary step in state government to report findings relating to critical business tax policies California has adopted to encourage businesses to locate and expand in California, duplicating existing evaluations conducted by the Department of Finance and others. At a time when California’s state budget is facing cost pressures, and the Legislature and administration are seeking to minimize new program costs, any duplicative program that creates new costs for an evaluation that already exists is not necessary. While it is meritorious for the state to assess the effectiveness of tax policies and program expenditures, this measure would create significant uncertainty with respect to the future of the state’s tax structure and would adversely affect California’s ability to retain and attract jobs and investments.”

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5/16/26 11:16:01

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