Tax Breaks: California's $60 Billion Loss

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High-Income Households and Corporations Benefit the Most From California's Tax Breaks

California loses a large amount of state revenues through tax breaks, also called "tax expenditures," with much of the benefits going to high-income households and corporations. Personal income and corporate income tax expenditures combined are projected to amount to more than $63 billion in forgone state revenues in 2019-20 (the fiscal year that started on July 1, 2019), or an amount equivalent to more than 40% of the 2019-20 General Fund budget. This is revenue that otherwise could go to Californians who need additional support to be able to live and work in the state while strengthening the state's economy.

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California Budget & Policy Center

The California Budget & Policy Center was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The Budget Center engages in independent fiscal and policy analysis and public education with the goal of improving the economic and social well-being of Californians with low and middle incomes. Support for the Budget Center comes from foundation grants, subscriptions, and individual contributions. Please visit the Budget Center's website at www.calbudgetcenter.org.

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tax breaks are debated at all, those discussions are largely deliberated outside of the usual budget cycle, reducing opportunities for advocates and the public to provide input on how the state is making fiscal decisions. Some of the largest tax expenditures – for example, the Mortgage Interest Deduction and the Water's Edge Election – help higher-income households and businesses that do not need the help, or need it much less, while also reducing the resources available for individuals and families who do need support. This "upside-down" nature of the state's tax expenditures also contributes to the racial wealth gap, as households with higher income and wealth that benefit most from many tax breaks are less likely to be comprised of people of color. Furthermore, it may be more effective to pursue many of the state's policy goals through spending directly on services that benefit more Californians rather than indirectly through the tax code. California could improve its use of tax expenditures by setting sunset dates, requiring their periodic evaluation, and better targeting their benefits to low- and middle-income households. Doing so would free up funding that could be used to invest in policies that provide greater opportunities for millions of Californians that struggle with the cost of living to increase their incomes and wealth.

Introduction

Deliberations on the state's spending on programs and services are often very visible and publicly debated. However, California also spends a significant amount of public dollars through tax breaks – also called "tax expenditures." Unlike program spending, most tax breaks are not up for debate every year, and instead quietly continue from year to year and are largely deliberated upon outside of the usual budget cycle – if they are debated at all. In 2019-20 (the state fiscal year that started on July 1, 2019), state personal income tax expenditures are projected to cost the state $57.5 billion, and another $5.7 billion in state revenue will be forgone due to corporate income tax expenditures.[1] Total spending on many tax breaks is not capped, as the tax breaks are provided to all who qualify. Some of the largest, most expensive tax expenditures are: 1) tax deductions and exclusions that benefit the rich much more than they do low- and middle-income households, and 2) tax breaks for businesses that serve questionable purposes or are of questionable effectiveness. In this way, California spends enormous amounts of public dollars helping households and businesses that do not need the help, or need it much less, while reducing the resources available for individuals and families who do need support to be able to live and work in California.

Additionally, since Black and Latinx households are overrepresented in lower-income groups and underrepresented in higher-income groups due to historical and ongoing discrimination, they benefit less than white households from many tax breaks.[2] State tax expenditures also contribute to the racial wealth gap – the dramatic difference in median net worth (assets minus debts) between families of different races and ethnicities. In 2016, the median white family's wealth nationally was $171,000, compared to $17,600 for Black families and $20,700 for Latinx families.[3] Many tax breaks aim to encourage households to build wealth through homeownership, retirement savings, and savings for higher education. Since many households of color – particularly Black and Latinx households – have less means to save and invest and face ongoing discrimination that makes it harder to build wealth (such as being denied access to homeownership and jobs with retirement benefits), they receive less benefit from these types of tax expenditures. Meanwhile, white families that are already wealthier are more likely to be able to purchase homes and save for their futures even without the additional tax incentives, but are rewarded with tax breaks nonetheless, widening the wealth gap.

This report examines some of the better-known tax expenditures in California for individuals and families as well as businesses. Among the issues considered are: 1) how the benefits of those tax expenditures are distributed, in the cases where that data is available; 2) whether the tax expenditures have worthwhile policy goals; and 3) whether they are effective in achieving those goals. The report then raises the critical question of whether revenues lost to tax expenditures would be better spent directly on public services. Finally, the report concludes with recommendations on how to improve the way California creates, evaluates, and renews tax expenditures to better serve more Californians.

Background

Tax expenditures are exceptions to "normal tax law" and include, but are not limited to, exemptions, deductions, exclusions, credits, deferrals, elections, and preferential tax rates.[4] Most of the tax expenditures discussed in this report are credits, deductions, or exclusions. Tax expenditures reduce the amount of tax revenue collected relative to the state's basic tax structure, thus reducing the amount of revenue the government has available to spend on other priorities – the same way direct spending on one program means that funding is not available for another program. For instance, since tax expenditures reduce state General Fund revenue, this in turn can reduce the state's Proposition 98 minimum funding guarantee for K-12 schools and community colleges. But there is a key difference between tax expenditures and direct spending: repealing a tax expenditure in California requires a two-thirds vote in both houses of the Legislature, while reducing or eliminating program spending only requires a simple majority.

Like other public services and systems, tax expenditures can have policy goals. For example, with the goal of encouraging homeownership, the Mortgage Interest Deduction allows taxpayers to reduce their taxable income, and hence their tax liability, by the amount of qualifying mortgage interest they paid during the year. However, whether or not a particular tax expenditure is *effective* in achieving its policy goals is a question that should be considered before enactment, and reevaluated periodically, just as policymakers do with direct program spending.

Many households across the income distribution benefit from tax expenditures without having to actively claim them when filing taxes, and some tax expenditures primarily benefit Californians with low and middle incomes. However, state spending on tax expenditures that primarily benefit the wealthy and tax expenditures for businesses far exceeds state spending on tax expenditures targeted to low- and middle-income households (Figure 1).

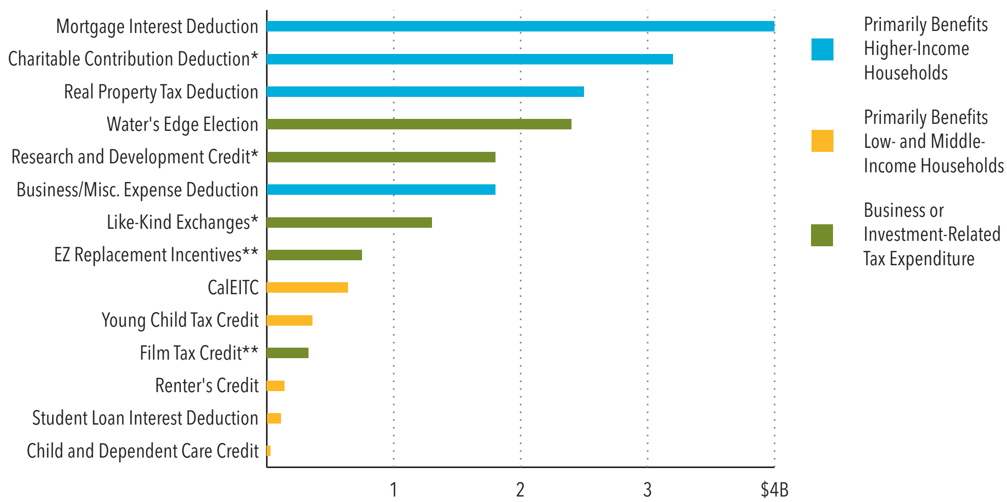
A Note About Sources and Estimates:

Unless otherwise noted, the estimates of the cost and distributional impacts of the personal income tax and corporate tax expenditures covered in this report are from the Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data* (the most recent published data). The Department of Finance's *Tax Expenditure Report 2019-20* also contains useful information about California's tax expenditures, including sales and use tax exemptions, which are not covered in the Franchise Tax Board report. This report does not exhaustively cover all of the state's tax expenditures, but focuses on some of the largest and most inequitable of those catalogued in the Franchise Tax Board and Department of Finance reports. Finally, the Franchise Tax Board notes that the estimate of revenue loss due to a given tax expenditure is not necessarily equal to the revenue that would be gained by its repeal, since some tax expenditures interact with each other and some tax expenditures accumulate over time.

FIGURE 1

State Tax Breaks Mostly Benefiting the Wealthy and Businesses Far Exceed Those for Households of Less Means

Projected 2019-20 California Revenue Loss by Tax Expenditure, in Billions



* Includes corporate income tax and personal income tax components.
** Includes corporate income tax, personal income tax, and sales tax components.
Notes: Enterprise Zone (EZ) Replacement Incentives and the Film Tax Credit reflect legislated caps rather than projected expenditures.
Source: Department of Finance and Franchise Tax Board

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Tax Credits

Tax credits provide a direct reduction in tax liability and can be refundable or nonrefundable. If a credit is refundable and reduces a household's tax liability below $0, the household receives the negative balance back in the form of a tax refund payment from the government. With a nonrefundable credit, a household whose tax liability goes below $0 simply owes no taxes but does not get a refund for the balance. Thus, nonrefundable credits provide little to no benefit to lower-income households who have little to no personal income tax liability (but who do pay other state taxes, such as the sales tax and payroll taxes). Similarly, if a business owes no tax, it cannot benefit from a nonrefundable credit.[5]

Deductions and Exclusions

Some of the largest, most expensive tax expenditures are deductions and exclusions from income which benefit primarily wealthier households – and also provide greater benefits as household income increases. Deductions and exclusions lower a household's taxes by reducing taxable income, and the higher a household's tax bracket is, the greater the benefit that households receive for each dollar of income that is not taxed. For example, a California taxpayer in the very-high-income 12.3% bracket receives a benefit of 12.3 cents for every additional dollar deducted from their taxable income, while a taxpayer in the 6% bracket (such as a married couple earning the state median household income of about $75,000 in 2018 dollars) would only receive 6 cents for every additional dollar deducted from their taxable income.

The way these types of tax breaks are designed is "upside down" – higher-income households receive greater benefits but are less likely to need either financial assistance or additional incentives to engage in the kind of behavior that tax expenditures generally aim to promote, like buying a home or saving for college or retirement. Furthermore, in order to claim many deductions, a taxpayer has to itemize deductions – meaning that the taxpayer chooses to forgo the set value of the standard deduction and instead file for specific deductions, item by item. Itemizing deductions is only worthwhile if a household's combined deductions reduce its tax liability by more than the value of the standard deduction, and wealthier households tend to have more and higher expenses that they are able to deduct, such as larger homes – and potentially second homes – in more expensive neighborhoods. More than three-quarters of California taxpayers with annual incomes of $100,000 or above (76.5%) itemized their state tax deductions in 2016, compared with just 16.9% of those with incomes less than $50,000, according to Franchise Tax Board data.[6]

For these reasons, deductions and exclusions are less beneficial to Black and Latinx households that are less likely to be in the higher-income groups that have higher tax rates and are more likely to itemize their deductions.

Deferrals

Deferrals delay recognition of income, lowering taxable income for the period that the deferral is taken. For example, tax-deferred retirement savings plans like 401(k)s defer taxes owed on income saved and earned within those accounts until the taxpayer ultimately withdraws this income. It is also possible for recognition of income to be deferred indefinitely,

What Do the Recent Federal Tax Law Changes Mean for California Tax Expenditures?

At the end of 2017, sweeping changes to the federal tax code were signed into law through the Tax Cuts and Jobs Act. To partially offset revenue losses from reducing the corporate and individual tax rates, the Tax Cuts and Jobs Act limited some federal tax expenditures and eliminated others. Many of the state tax expenditures discussed in this report are linked to or modeled after federal tax expenditures, some of which were limited or repealed by the Tax Cuts and Jobs Act. These include the Mortgage Interest Deduction, the Real Property Tax Deduction, the Employee Business and Miscellaneous Expenses Deduction, and Like-Kind Exchanges. California lawmakers have the ability to select which pieces of federal tax law to "conform to," or adopt into the state's tax code. In the 2019-20 budget agreement, state lawmakers either fully or partially conformed to a handful of the changes made by the Tax Cuts and Jobs Act, including new limitations on Like-Kind Exchanges.[7] As of this publication, the state has not conformed to the changes made to the other tax expenditures listed above.

However, even if the state does not conform to these provisions, the scaling back of federal tax breaks may change taxpayer behavior, which could affect both the cost and distribution of the state tax breaks. While revenue estimators have attempted to incorporate potential behavioral changes into the estimates of state revenue losses presented in this report, some of these behavioral impacts are difficult to predict and may take some time to fully materialize. For this reason, the revenue estimates included in this report are more uncertain than they generally are.[8]

As an example of how the federal changes could impact estimates of California tax expenditure revenue losses, new California homebuyers who might have previously selected higher cost homes may decide to purchase less costly houses due to the new federal limits on the Mortgage Interest Deduction and the State and Local Tax (SALT) deduction. This would result in the state forgoing less revenue from its deductions for mortgage interest and real property tax than it would have in absence of the federal changes.

leaving income that a taxpayer has already received untaxed indefinitely. Like-Kind Exchanges, discussed later in this report, are another example of a deferral.

Elections

Tax elections give taxpayers a choice among different tax treatments. For example, the Water's Edge Election, discussed later in this report, gives corporations a choice of how to determine the proportion of their worldwide income that can be attributed to California for the purpose of calculating their tax liability. Given a choice, taxpayers would be expected to take the tax treatment that results in lower taxes. However, which option happens to be most advantageous for a taxpayer can change depending on circumstances. Thus, tax elections end up reducing revenues below what they would have been if taxpayers were not allowed to choose their tax treatment.

Personal Income Tax Expenditures

Large "Upside-Down" Tax Expenditures Aimed at Homeowners

Two homeownership-related tax deductions, the Mortgage Interest Deduction and the Real Property Tax Deduction, provide several billions of dollars in tax breaks to households with incomes of $100,000 or more, who are the top 20% of California earners.[9]

The Mortgage Interest Deduction allows households to reduce their taxable incomes by the value of qualified mortgage interest expenses paid on up to $1 million in debt. Of the total $3.5 billion in reduced tax revenue from this deduction in 2016, $2.8 billion (79.1%) went to households with incomes of $100,000 or more (Figure 2). At the same time, these households represented just over half (51.2%) of households claiming the deduction.

The Real Property Tax Deduction allows households to reduce their taxable income by the amount of tax they paid to local, state, or foreign governments on real property, such as land and buildings. Of the total $2 billion in forgone 2016 tax revenue from this deduction, $1.7 billion (82.2%) went to households with income of at least $100,000 (Figure 3). These households represented just 50.4% of households claiming the deduction.

The state's tax code provides another large benefit to homeowners in the form of an exclusion of the capital gains from selling one's home up to $250,000 ($500,000 for joint filers). The Exclusion of Capital Gains on Sale of a Principal Residence is projected to cost $3.7 billion in 2019-20. Information on the distribution of the benefits of this exclusion is not available, though it clearly only benefits households that can afford to purchase homes.

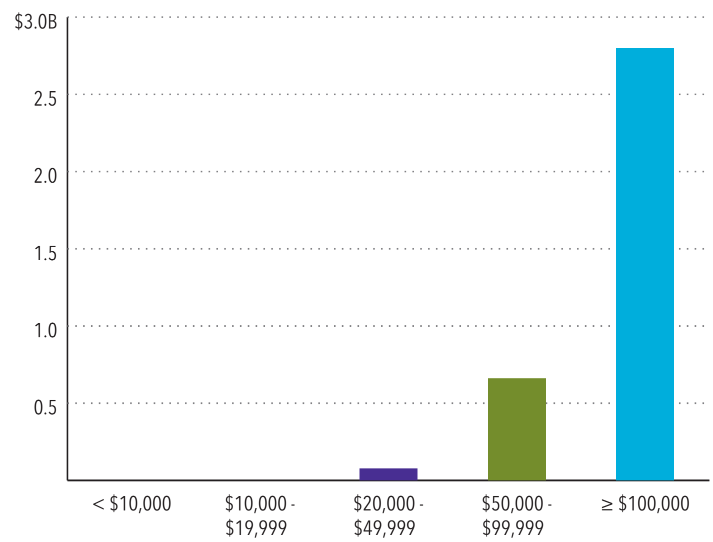
Tax deductions and exclusions related to homeownership contribute to the racial wealth gap by providing greater benefits to white households than to households of color that have lower rates of homeownership, partly as a result of historical racist policies and ongoing housing discrimination.[10] In California, only one-third (33.3%) of Black households, 42.3% of Latinx households, and 46.5% of Native American households owned their own homes in 2016, compared to more than 6 in 10 white households (62.5%).[11] In other words, far fewer of these households are even eligible to claim tax deductions and exclusions related to homeownership.

While the ostensible purpose of homeownership-related tax breaks is to increase homeownership, it is not clear that they help households purchase homes that would not have done so in the absence of the incentives. The value of these tax breaks serves to increase the price of property because sellers and buyers know that the ultimate cost of a property to its owner is effectively lower due to the ability to take the tax deductions.[12] In other words, if these deductions are meant to subsidize homeownership, they are not very effective since the value of the deductions has been "capitalized" into the price of a property, and the buyer is no better off.

FIGURE 2

California's Mortgage Interest Deduction Primarily Benefits Higher-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Billions)



Note: The tax benefit received by tax filers in the "< $10,000" and "$10,000 - $19,999" adjusted gross income groups was $0.8 million and $0.7 million, respectively.
Source: Franchise Tax Board

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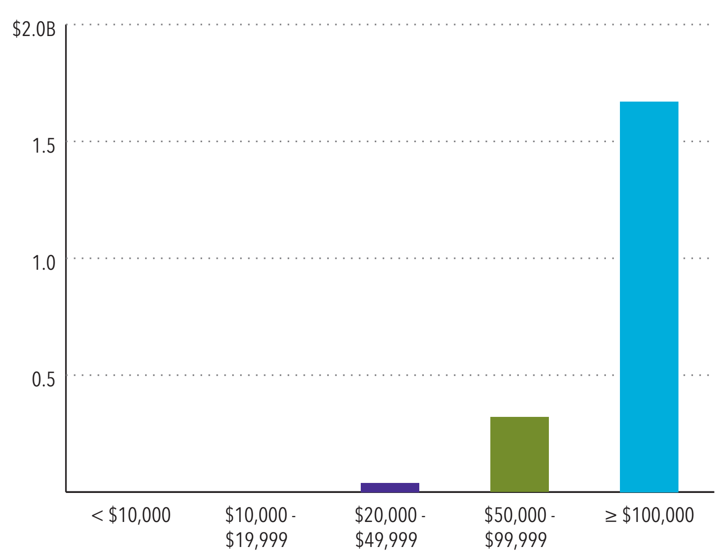
FIGURE 3

California's Real Property Tax Deduction Primarily Benefits Higher-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Billions)



Note: The tax benefit received by tax filers in the "< $10,000" and "$10,000 - $19,999" adjusted gross income groups was $1.7 million and $0.3 million, respectively.
Source: Franchise Tax Board

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The fact that the value of the deductions is factored into prices also means that they contribute to the high cost of housing in California. While individuals and families who are already in a position to be able to purchase a home receive the large offsetting benefits of the Mortgage Interest and Real Property Tax deductions, higher prices make it harder for families with less income and wealth to purchase a home. The FTB notes that if the goal of the Mortgage Interest Deduction is to increase homeownership, then it might make more sense to give a large credit to *new* homeowners rather than "the current deduction that is most valuable to taxpayers who already own homes, but are moving to much bigger and more expensive ones."[13]

California's Mortgage Interest Deduction and Real Property Tax Deduction are both modeled after provisions in federal law. However, the Tax Cuts and Jobs Act scaled back both deductions at the federal level beginning in the 2018 tax year. For the Mortgage Interest Deduction, the Tax Cuts and Jobs Act lowered the mortgage debt cap from $1 million to $750,000 and limited the deduction for home equity loan interest. At the time of this writing, California has not adopted this change, so Californians can still claim the deduction on debt up to $1 million and on home equity loan interest. The Tax Cuts and Jobs Act also capped the federal State and Local Tax (SALT) Deduction at $10,000. California's Real Property Tax Deduction, which is based on the SALT deduction, is currently uncapped.

Charitable Contributions and Employee Expenses: Well-Intended Deductions That Primarily Benefit Higher-Income Households

Charitable Contributions

Many tax expenditures that have reasonable policy goals still end up disproportionately benefiting wealthier taxpayers. One example is the Charitable Contribution Deduction, which allows itemizing taxpayers to deduct donations made to charitable, religious, and other nonprofit organizations, as well as governmental entities, generally up to a limit of 50% of the taxpayer's adjusted gross income (AGI). Additionally, taxpayers donating appreciated assets do not have to pay capital gains taxes on that increase in value. Corporations are also generally allowed to claim deductions for charitable contributions up to 10% of their net income.

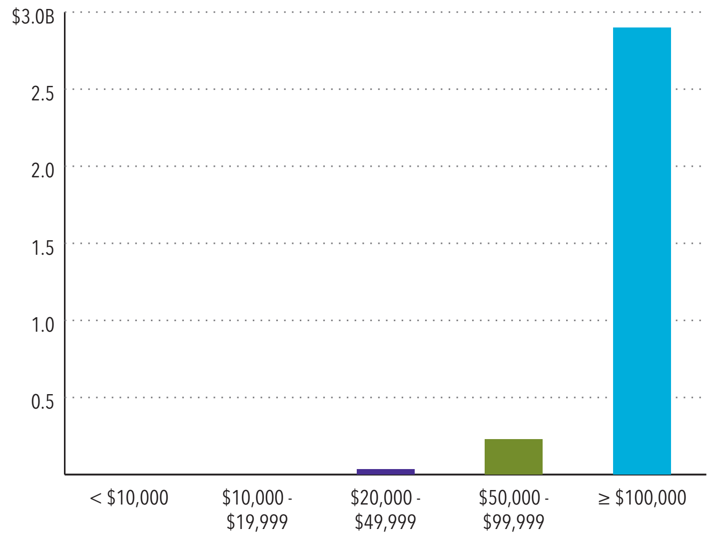
While encouraging contributions that may benefit society is a laudable goal, households with higher incomes who have higher tax rates and are more likely to itemize their deductions reap the largest share of tax benefits from the deduction. Of the $3.2 billion in lost personal income tax revenues due to this deduction in 2016, $2.9 billion (91.6%) went to taxpayers with incomes of $100,000 or more (Figure 4). The fact that the tax benefits are so skewed to high-income taxpayers also affects the types of charities that benefit from the incentive, because high-income and low- and middle-income households have different patterns of charitable giving. High-income taxpayers direct more of their donations to charities relating to arts, health, education, and the environment, while donors with lower incomes favor charities focused on basic necessities, community improvement, youth and family services, and religion.[14]

Various reforms to the federal Charitable Contributions Deduction have been proposed over the years that would reduce the cost of the deduction and/or make it more available to donors with low and middle incomes. Any reform would need to balance these two goals while also ensuring that the incentive to give is not substantially reduced. Reforms that have been suggested include: 1) capping the deduction; 2) capping the tax rate at which the deduction can be claimed; 3) setting a floor on the amount of contributions that can be deducted (either as a dollar amount or a percentage of adjusted gross income); 4) making the deduction available to taxpayers that do not itemize deductions; and 5) converting the deduction into a credit.[15] Of these options, only the latter two would allow more taxpayers with low and middle incomes to benefit, though they would need to be combined with other changes to ensure that revenue losses are minimized.

FIGURE 4

California's Charitable Contribution Deduction Primarily Benefits Higher-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Billions)



Note: The tax benefit received by tax filers in the "< $10,000" and "$10,000 - $19,999" adjusted gross income groups was $2.4 million and $0.2 million, respectively.
Source: Franchise Tax Board

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Employee Business and Miscellaneous Expense Deduction

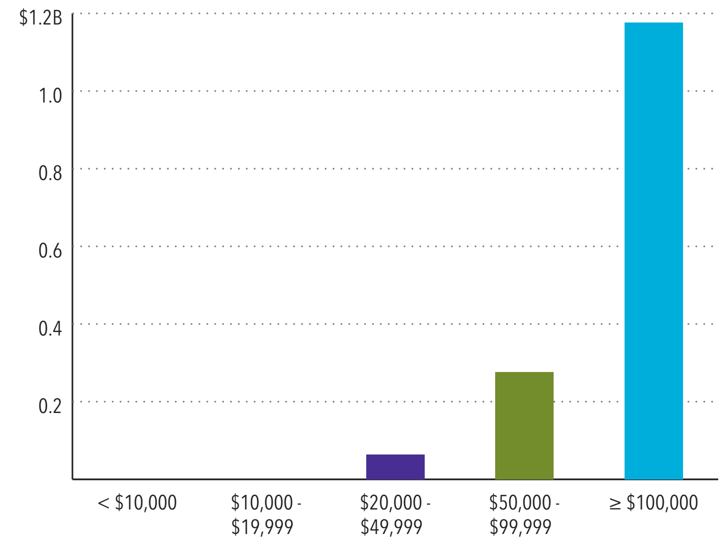
The Employee Business and Miscellaneous Expense Deduction allows itemizing taxpayers to deduct certain unreimbursed expenses, to the extent that such expenses exceed 2% of adjusted gross income. Deductible items include expenses employees incur that are not reimbursed by their employers, such as professional dues, tools and supplies, meals and travel, and union dues. Also deductible are expenses related to earning and collecting income that are unrelated to being an employee, such as investment fees and expenses. In 2016, $1.2 billion of the $1.5 billion in tax benefits (77.3%) from this deduction went to households with incomes of at least $100,000 (Figure 5). This deduction is modeled after a federal deduction that was eliminated by the Tax Cuts and Jobs Act between 2018 and 2025, but California has not conformed to this provision, so taxpayers can still claim this deduction against their state taxes.

While the deduction for employee and miscellaneous expenses may provide needed relief for employees with low and middle incomes that have unreimbursed work-related expenses, it is difficult to argue that taxpayers with high incomes should receive tax breaks for expenses related to investment income. This tax expenditure could be restructured to both reduce the costs to the state and distribute the benefits more equitably. For example, the deduction could be limited for taxpayers with incomes above a certain level, or it could be replaced with a tax credit that provides the same per-dollar benefit regardless of income and can be claimed by tax filers who do not itemize deductions, who generally have low or middle incomes. The size of the credit could also be capped to limit revenue losses.

FIGURE 5

California's Employee Business and Miscellaneous Expense Deduction Primarily Benefits Higher-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Billions)



Note: The tax benefit received by tax filers in the "< $10,000" and "$10,000 - $19,999" adjusted gross income groups was $4.9 million and $1.4 million, respectively.
Source: Franchise Tax Board

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Exclusions From Income That Are Available to Those That Do Not Actively Claim Them – but Which May Still Disproportionately Benefit Higher-Income Households

There are some tax expenditures that households do not have to actively claim on their returns, but automatically benefit from because certain types of income and employee compensation are excluded from their taxable income, thereby reducing their tax liability. Some of the largest tax expenditures in California are exclusions, including the exclusion of some employer-provided fringe benefits, Social Security benefits, and certain types of capital gains. For the most part, the FTB does not provide an analysis of how the benefits from these exclusions are distributed along the income scale, since taxpayers are not required to report these types of income. However, the structure of many of these exclusions favors higher-income taxpayers. First, as discussed above, exclusions translate to greater tax benefits for households in higher tax brackets than for low- and middle-income households in lower tax brackets. Second, taxpayers with higher incomes are more likely to receive these types of income and benefits than lower-income households.

Benefits that employers pay for or contribute to, like health insurance and retirement plans, represent things that employees would otherwise need to spend their own income on – they are part of an overall compensation package. In their absence, workers may have received a higher wage or salary in their place. However, these benefits, as nonmonetary compensation, are excluded from workers' taxable income. The two largest tax expenditures in California are exclusions of employment-related benefits. The Employer Contributions to Pension Plans Exclusion is the largest personal income tax expenditure in the state, with projected forgone revenue of $11 billion in 2019-20. Contributions to qualified retirement plans up to annual limits are excluded from employees' taxable income. The Employer Contributions to Accident and Health Plans Exclusion is the next largest income tax expenditure, with projected forgone revenue of $8.5 billion in 2019-20. Employer contributions to provide accident and health insurance are excluded from employees' taxable income.

Because higher-income households are more likely to have employer-provided benefits, they are more likely to benefit from these exclusions. For example, 86% of taxpayers with more than $200,000 in wage income participated in employer-sponsored retirement plans in 2014, compared to only 18% of those with wage income below $20,000 and 54% of those with wage income between $20,000 and $50,000.[16] Similarly, 83% of the nonelderly population with incomes above four times the federal poverty line was covered by employer-sponsored health coverage in 2014, compared to 12% of those living in poverty and 38% of those with incomes between one and 2.5 times the poverty line.[17] These tax breaks also provide differential benefits by race and ethnicity, since white households are more likely to have access to workplace retirement plans and to be covered by employer-sponsored insurance than households of color.[18]

California excludes all Social Security benefits from households' taxable income, in contrast to the federal government, which taxes a portion of Social Security benefits for households with incomes above a specified level ($25,000 for individual taxpayers and $32,000 for joint filers).[19] As the FTB notes, Social Security represents both poverty relief and pension savings – thus, it is reasonable to exclude the portion of benefits that represents poverty relief, while it would be more appropriate to treat the pension savings portion of benefits similar to other pension savings, which are generally taxed when withdrawn.[20] Since the federal tax code only fully excludes Social Security income for low-income taxpayers, the vast majority of benefits from the partial exclusion are realized by low- and middle-income households.[21] However, since California does not tax Social Security income at all, a large share of the benefits from the state's exclusion of Social Security income that *is* subject to federal income tax goes to higher-income households. The FTB estimates that the total state revenue loss from not taxing Social Security income was $3.5 billion in 2016, of which $1.8 billion was related to income that was reported on federal income tax returns and subject to federal tax. Of that $1.8 billion, nearly half ($904.4 million, or 49.0%) went to taxpayers with incomes of at least $100,000. California's full exclusion of Social Security income is projected to cost the state $4.3 billion in 2019-20.

In addition to the exclusion of capital gains from selling a primary residence, discussed above, California also conforms to federal law in allowing heirs to exclude the capital gains accrued before the decedent's death when selling inherited assets. As an example, if a father purchased property for $500,000 that had appreciated to $750,000 by the time it was left to his child, the child could then sell the property and pay no capital gain tax on the $250,000 increase in value. The heir would only owe tax on any further increase in value starting from the time of inheritance. This provision, referred to as Basis Step-Up on Inherited Property, is projected to cost $3.2 billion in 2019-20. As FTB notes, the original rationale for this exclusion was that heirs had to pay an inheritance tax, so imposing a tax on capital gains of inherited assets would be double taxation – but California does not currently have an inheritance or estate tax.[22] In effect, some capital gains on assets that are held until death are never taxed. Moreover, since lower-income households and households of color inherit less wealth than white households, they receive less benefit from this exclusion.[23] FTB does not provide state-level distributional data on the Basis Step-Up of Inherited Property, but an estimated 65% of the benefits of the corresponding federal exclusion went to the top 20% of taxpayers nationwide in 2013, according to an analysis by the Congressional Budget Office.[24]

Targeted – but Relatively Small – Tax Expenditures for Households in Need of Support

California has several tax expenditures that are targeted at Californians who need help with the cost of living and building toward a better life. These include the Student Loan Interest Deduction, the

Renter's Credit, the Child and Dependent Care Credit, the California Earned Income Tax Credit (CalEITC), and the Young Child Tax Credit. All of these tax expenditures are limited to tax filers with incomes below a certain threshold and either phase out the tax benefit as a household's income approaches that limit or, in the case of the Renter's Credit, simply cut off the benefit above that ceiling. These mechanisms help to target the benefits of tax expenditures toward the households in more need of help rather than mostly benefiting higher-income households like the tax expenditures discussed above. However, with the exception of the CalEITC and the Young Child Tax Credit – which are refundable credits – these tax expenditures provide very little benefit for Californians with the lowest incomes.

Student Loan Interest Deduction

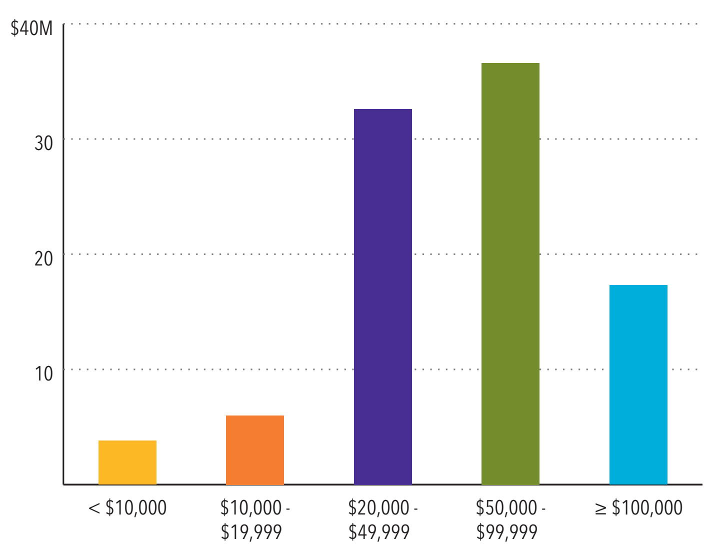
The Student Loan Interest Deduction allows households to reduce their taxable income by the amount of qualified student loan interest they paid during the tax year, up to a maximum of $2,500. This deduction benefits low- and middle-income households the most. Households with income between $20,000 and $100,000 comprised 70.6% of claimants and received 71.9% of the benefits of this deduction in 2016. (Figure 6 shows the dollar distribution of benefits.) The deduction phases out above certain levels of income, ensuring that the benefit stays targeted toward those with greater need.[25] Total spending on the Student Loan Interest Deduction in 2016 was $96.4 million.

Unlike the Mortgage Interest and Real Property Tax deductions, the Student Loan Interest Deduction does not require itemization in order to claim it, which makes it available to more low- and middle-income households. However, FTB data show that this deduction does not reach many of the lowest-income households. Those with incomes under $20,000 represented just 11.8% of claimants and received only 10.2% of the benefits, though they made up more than one-quarter (27.2%) of all tax filers, possibly because individuals in these households are less likely

FIGURE 6

California's Student Loan Interest Deduction Primarily Benefits Low- and Middle-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Millions)



Source: Franchise Tax Board

to have attended college or because their incomes are too low to owe any personal income tax. The Student Loan Interest Deduction also represents a very small amount of spending compared to other tax expenditures like the homeownership-related tax deductions discussed above.

Renter's Credit and Child and Dependent Care Credit

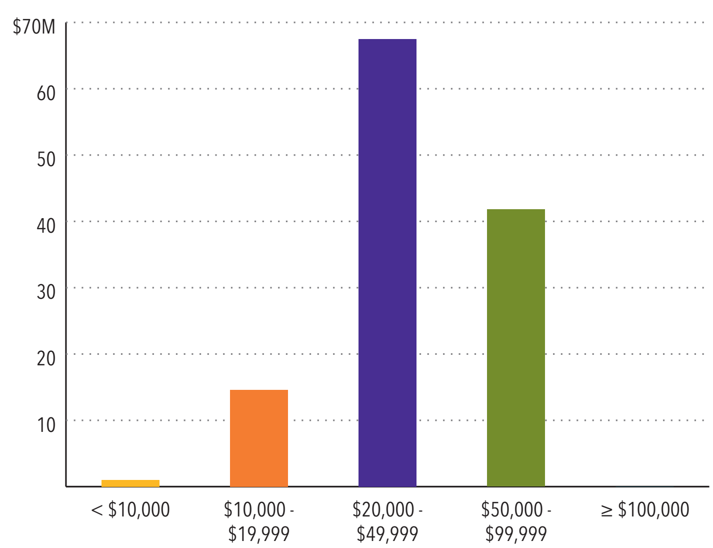
The Renter's Credit and the Child and Dependent Care Credit also primarily benefit low- and middle-income households. As tax credits, they provide a direct reduction in tax liability (in contrast with deductions, which reduce tax liability by reducing taxable income). However, both credits provide little to no benefit to the lowest-income households because they are nonrefundable credits, and these households often do not owe personal income taxes. This means that if a credit reduces a household's tax liability below $0, the household simply owes no taxes. Were the credit refundable, the household could receive the balance back in the form of a tax refund. Further, the amount of money spent through the Renter's Credit and the Child and Dependent Care Credit (about $125 million and $32 million in 2016, respectively) is miniscule compared to the multibillions provided to the top 20% of taxpayers through the itemized deductions and exclusions discussed above.

The Renter's Credit provides a $60 reduction in tax liability to individuals ($120 to married couples filing jointly) who paid rent on a residence in California for at least half the year. The vast majority (87.5%) of the benefits of the Renter's Credit in 2016 went to households with incomes between $20,000 and $100,000. Households with incomes below $20,000, who made up nearly one in five (19.5%) of those claiming the credit, received 12.5% of the benefits (Figure 7 shows the dollar distribution of benefits). As noted above, the Renter's Credit is nonrefundable. Households cannot claim the credit if their California adjusted gross income exceeds specified thresholds, which are annually adjusted for inflation. For the 2018 tax year, that threshold was $41,641 for individuals and $83,282 for married couples filing jointly.

FIGURE 7

California's Renter's Credit Primarily Benefits Low- and Middle-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Millions)



Note: In tax year 2016, the Renter's Credit was only available to tax filers with adjusted gross income up to $39,062 ($78,125 for joint filers). These amounts are adjusted annually for inflation.
Source: Franchise Tax Board

California Budget & Policy Center
Independent Analysis. Shared Prosperity.

California's Child and Dependent Care Credit is a tax credit that offsets a portion of expenses incurred by working families for child care and care of other dependents.[26] The state credit is equal to a percentage of the federal credit, and that percentage decreases as income rises. The maximum state credit is $525 for households with one dependent and $1,050 for those with more than one dependent. Of the households receiving the credit in 2016, 85.5% had incomes between $50,000 and $99,999, and they received 90.6% of the tax benefits (Figure 8 shows the dollar distribution of benefits). One reason that the credit reaches a relatively narrow band of the income distribution is that, it is not available to households with federal adjusted gross income above $100,000 (unlike the federal credit, which is not subject to an income limit). The other critical reason is that the credit is nonrefundable, so few households with very low incomes benefit. Just 0.1% of households receiving the Child and Dependent Care Credit in 2016 had income below $20,000, and they received 0.1% of the total amount spent on this credit. Furthermore, because child care is so expensive, it could still be out of reach for families with low and even middle incomes even if the credit were refundable.

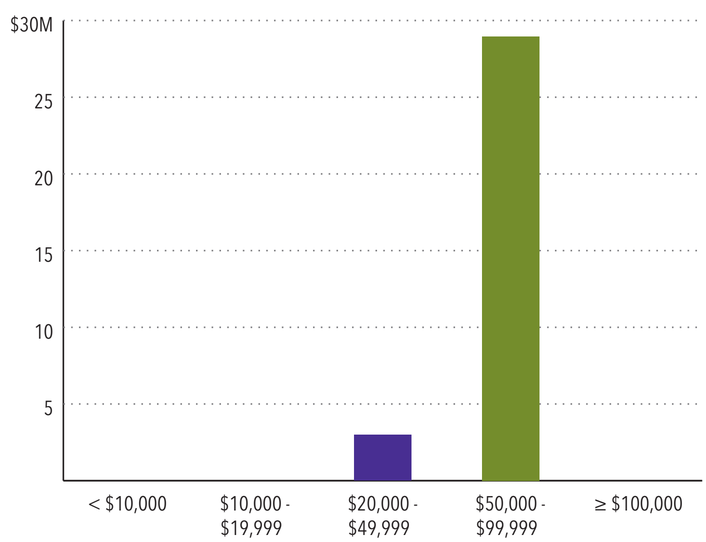
California Earned Income Tax Credit and Young Child Tax Credit

California enacted its first-ever state Earned Income Tax Credit (called the CalEITC) in 2015. This refundable credit boosts the incomes of workers with low wages. The credit scales up for higher levels of earnings up to a maximum point, after which the credit phases out. The Young Child Tax Credit, an additional credit for CalEITC-eligible families that have children under age 6, was enacted in 2019 along with other expansions to the CalEITC. As the state's only refundable credits, the CalEITC and the Young Child Tax Credit are the only state tax expenditures that directly benefit the lowest-income workers in California.[27]

FIGURE 8

California's Child and Dependent Care Credit Primarily Benefits Low- and Middle-Income Households

Total State Tax Benefit Received by Adjusted Gross Income Group, 2016 (Millions)



Note: The tax benefit received by tax filers in the "< $10,000," "$10,000 - $19,999," and "≥ $100,000" adjusted gross income groups was $10,000, $14,500, and $6,400, respectively.
Source: Franchise Tax Board

California Budget & Policy Center
Independent Analysis. Shared Prosperity.

When first enacted, the CalEITC was only available to households with annual earnings below about $7,000 to $14,000, depending on family size. Subsequent budget agreements have expanded the credit to reach more households by increasing the income limits, allowing self-employed individuals to claim the credit, and extending eligibility to young adults and seniors. The 2019-20 budget agreement significantly expanded the credit further by increasing the income limit to $30,000 (roughly equal to the full-time earnings of a worker earning $15 per hour) and increasing the size of the credit for some filers that previously received relatively small credits. With these expansions, the amount spent on the CalEITC is projected to rise from $372 million in tax year 2018 to $640 million in tax year 2019.[28]

The 2019-20 budget agreement also created the Young Child Tax Credit, which is an additional $1,000 credit for families that qualify for the CalEITC, have at least one child under age 6, and have annual earnings between $1 and $25,000. The credit phases out for families with incomes between $25,000 and $30,000, so these families will receive a "young child" credit of less than $1,000. In tax year 2019, the Young Child Tax Credit is estimated to cost $360 million, and together with the CalEITC, will provide $1 billion in cash assistance to 3 million low-income California households.[29] These credits also help to reduce racial and ethnic income disparities, as people of color represent 74% of Californians eligible for the CalEITC and 85% of those eligible for the Young Child Tax Credit.[30]

The CalEITC and Young Child Tax Credit are also notable in that policymakers are required to decide each year through the state's budget process whether to provide the credits and how much to spend on them, similar to direct spending programs.[31] This sets the CalEITC and Young Child Tax Credit apart from most other tax expenditures, which are not subject to annual review and cannot be reduced or eliminated without a two-thirds vote of each house of the Legislature.

Sales Tax Expenditures

Along with other spending through the tax code, California will lose an estimated $9.6 billion in General Fund revenue to sales and use tax expenditures in 2019-20 and an additional $11 billion in local government revenues, according to the Department of Finance (DOF).[32] Sales and use taxes only apply to tangible goods that are not specifically exempt, and not to the purchase of services. The largest sales tax expenditures are exemptions for purchases of items considered to be necessities, including many food products, prescription medicines, and utilities. The 2019-20 budget agreement created new temporary exemptions for diapers and feminine hygiene products on the basis that they are necessities. The rationale for exempting "necessity" items is that lower-income households spend larger shares of their income on these items, so exempting them makes the sales tax less regressive. However, the definition of "necessity" can be debated, and the state and local governments also lose significant revenues from exemptions for other types of goods, such as candy and snack foods, certain types of business and farm equipment, and printed advertising. Further, while the DOF does not consider the exclusion of services from sales tax to be a tax expenditure, the Board of Equalization estimated in 2015 that applying sales tax to all currently untaxed services could generate more than $120 billion in state and local revenues, including over $50 billion in state General Fund revenue.[33] There is no available data on the distribution of the benefits of sales tax exemptions, but they represent a substantial public expenditure that should be reviewed and enacted with careful deliberation.

Business and Investment-Related Tax Expenditures

Contrary to the popular perception of the private sector as being independent and financially self-sufficient, businesses – particularly large corporations – also benefit from state spending via tax expenditures. Each of the three largest business and investment-related income tax expenditures – the Water's Edge Election, the Research and Development Credit, and Like-Kind Exchanges – are projected to reduce state revenues by more than $1 billion in 2019-20. None of these three tax expenditures has a cap on annual spending or an expiration date. Furthermore, California's business and investment-related tax breaks serve purposes of dubious value or are of questionable effectiveness, and yet continue from year to year without scrutiny from policymakers.

Water's Edge Election

The Water's Edge Election is the state's largest business tax expenditure, projected to cost $2.4 billion in 2019-20. The election allows multinational corporations to choose whether or not to exclude earnings or losses derived from foreign parts of their business in calculating the proportion of their income that is taxable in California. The standard method for determining the California share of a corporation's income is known as "worldwide combined reporting," which looks at the share of the business' worldwide income that is attributable to California. Worldwide combined reporting protects against state revenue losses resulting when corporations shift income that was actually earned in California into affiliated businesses in foreign tax havens in order to lower their tax bill.[34] Alternatively, corporations can elect to file on a Water's Edge basis, which looks at California's share of, for the most part, only United States income. The ability of corporations to choose whichever method minimizes their tax liability makes the Water's Edge Election a tax expenditure.

Prior to 1986, this option did not exist. However, as opposition from multinational corporations and international governments grew against the state's policy of mandatory worldwide combined reporting, California passed a law in 1986 implementing the Water's Edge Election.[35] This ability to choose how to calculate their taxes gives corporations the ability to strategically reduce their taxable income, resulting in less tax collected than would be under a mandatory worldwide or mandatory domestic combined reporting scheme. For example, if the foreign parts of a multinational corporation had net losses in a tax year, then including them in the calculation of income for the year would make the end result lower – resulting in lower taxable income in the US (and hence California). On the other hand, if the foreign components had *positive* net income in a tax year, then including them in the calculation of income for the year would make the end result higher – resulting in higher taxable income in the US (and hence California). Given the option, a corporation would likely choose whichever method results in lower taxes owed. And since this option only benefits multinational corporations, smaller domestic businesses are put at a competitive disadvantage.

Research and Development (R&D) Credit

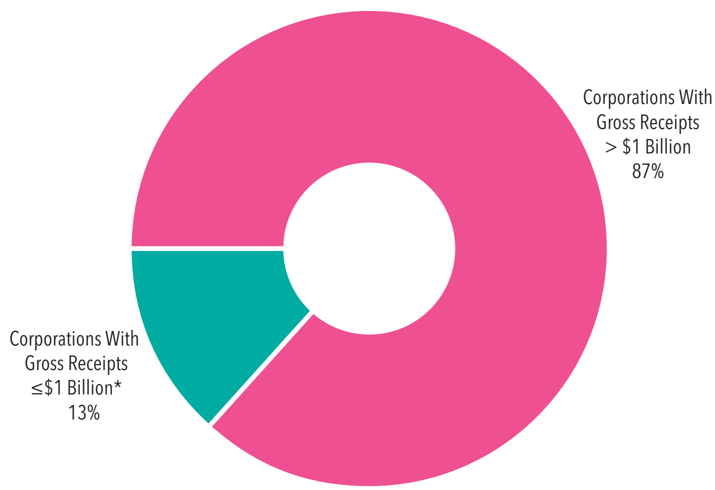
The R&D Credit is the state's second-largest business tax expenditure, with a projected cost of $1.8 billion in 2019-20. Businesses receive a tax credit for a portion of increased research expenditures relative to a four-year base period. The vast majority – 86.8% – of total spending on this credit for corporations went to those with gross receipts of more than $1 billion in 2016, even though these businesses made up only 6.9% of those receiving the credit (Figure 9).[36] This credit is meant to encourage businesses to conduct the "optimal" amount of R&D for society, and in particular to do so in California instead of other states.[37] Since there is also a larger federal R&D credit that is available to taxpayers in all states, the extra tax credit California provides is meant to attract businesses to conduct R&D activity in California.

The FTB notes that the credit could only be considered successful if R&D activity is taking place in

FIGURE 9

California's Research and Development Credit Primarily Benefits Large Corporations

Total Tax Credits Received by Corporations in 2016 = $1.5 Billion



* Also includes corporations with unknown gross receipts.
Note: Chart excludes $170 million in credits claimed on personal income tax returns.
Source: Franchise Tax Board

California that would not happen without the credit, but the extent to which this is occurring is unknown.[38] Several researchers that have studied state R&D tax credits have concluded that the credits are at least somewhat effective in increasing state-level R&D spending.[39] However, some evaluations of individual state R&D credits have concluded that the benefits do not justify the costs.[40] For instance, Washington allowed its credit to expire after determining that the credit cost per job created was too high.[41] In a 2016 review of some of California's corporate tax expenditures, the State Auditor's office noted that it was "unable to determine the R&D credit's effectiveness because no state entity oversees or regularly evaluates it."[42]

As one indicator that California's R&D credit is overly generous, the amount of credits generated each year far exceeds the credits used. If a business does not have enough tax liability to fully utilize its credit in a given tax year, it can carry forward the unused balance indefinitely to reduce its taxes in future years. The unused carryforward balance of R&D credits grew by an estimated $4.3 billion in 2017 to a new total of $28.4 billion, as recipients only used $1.4 billion of the nearly $5.8 billion in credits generated, according to the latest figures from the FTB.[43] This balance represents a large and growing future liability to the state.

The Legislative Analyst's Office (LAO) gave testimony to the Assembly Revenue and Taxation Committee in 2011 in which it referred to its 2003 report on tax expenditures and reiterated its recommendation that the Legislature reduce or phase out the credit. The LAO "noted that direct research-related spending (such as through the University of California) may well be a more cost-effective means of subsidizing R&D."[44]

Like-Kind Exchanges

Normally, selling or exchanging property at a profit results in a capital gain subject to tax. Like-Kind Exchanges allow taxpayers to defer capital gains (or losses) when they exchange a business or investment property for a similar ("like-kind") property.[45] This rule

The Case of the Disappearing Tax Expenditure: Single Sales Factor Apportionment

Corporations with income derived from both inside and outside of California are not taxed on their whole incomes, but rather apportion their income among the states in which they operate, with California taxing just the portion attributed to California. Prior to 1993, California used a formula to apportion a corporation's income to the state using an "equal-weighted three-factor" method based on the percentage of its sales, payroll, and property that were in California relative to its total sales, payroll, and property, with each of the three factors given equal weight. In 1993, the state moved to a "double-weighted sales" formula in which the sales factor was given double weight. For tax years 2011 and 2012, corporations were given a choice between the double-weighted sales formula and a "Single Sales Factor Apportionment" formula based solely on the percentage of their sales in California.[46] Then California voters passed Proposition 39, which required corporations to use the Single Sales Factor method beginning in 2013.[47]

Three-factor apportionment takes into account both production activity (property and payroll) and sales activity, both of which are necessary in producing a company's profits. By contrast, Single Sales Factor Apportionment allows corporations to game the system by strategically locating their production factors and targeting sales in certain states.[48] The move to Single Sales Factor Apportionment has created winners and losers. Manufacturing companies that have more property and payroll in the state while largely selling to out-of-state customers reap tax benefits, but those that sell more to consumers in California with less in-state physical presence end up owing more in taxes.

In the previous version of this report, Single Sales Factor Apportionment was included as corporate tax expenditure estimated to cost over $1 billion relative to the equal-weighted three-factor apportionment method. The FTB and the DOF no longer consider Single Sales Factor Apportionment to be a tax expenditure because a majority of states now use this method. However, FTB's Chief Economist has estimated that the move from the double-weighted three-factor apportionment formula to Single Sales Factor Apportionment, in combination with some other changes to how the sales factor is calculated, resulted in a net loss of $500 million in revenues in 2015-16.[49]

does not apply to inventory, stocks, bonds, notes, other securities, or to property for personal use.

The deferred capital gain is recognized if the new asset is sold or exchanged in a subsequent taxable transaction. However, if the new asset is later exchanged in a Like-Kind Exchange, capital gains can be deferred indefinitely.[50] Furthermore, if the owner of the property passes it on to an heir instead of selling it, the capital gain will never be taxed due to the "Basis Step-Up on Inherited Property" tax expenditure, discussed above.

Although Like-Kind Exchanges were originally meant to exempt small, informal barter transactions from tax and reporting requirements, today individuals and businesses wishing to conduct a Like-Kind Exchange of real estate properties typically avail themselves of a "nationwide industry of commercial intermediaries specializing in the transactions" – in other words, transactions that are not small, informal barter.[51]

The Tax Cuts and Jobs Act eliminated federal Like-Kind Exchanges for personal property (such as trade-ins of vehicles used for business purposes) while preserving Like-Kind Exchanges for real estate.

California's 2019-20 budget agreement partially conformed to this change, so Like-Kind Exchanges of personal property occurring after January 10, 2019 are not eligible for state tax deferral unless claimed by an individual taxpayer with an income less than $250,000 ($500,000 for joint filers, heads of household, and surviving spouses). Even after this limitation, Like-Kind Exchanges are estimated to cost $1.3 billion in state revenue in 2019-20.

Competitive Tax Breaks for Businesses May Not Significantly Benefit the State Economy

There are also smaller business tax expenditures that California allocates competitively rather than making available to all who qualify. The Film Tax Credit and California Competes Tax Credit are structured to limit state expenditures via capped annual allocations of dollars and legislated expiration dates. Still, it is unclear how effective these tax credits are in achieving their intended goals of economic and job growth, and they reduce revenues available for other priorities that might be more effective in promoting these goals such as investments in education, job training, and skills development.

Film Tax Credit

The Film Tax Credit is awarded by the California Film Commission (CFC) and is meant to attract and retain film and television production in California. The Commission can award up to $330 million per fiscal year through 2024-25, and the credit can be claimed against corporate income, personal income, or qualified sales and use taxes.[52] Unallocated credits in one year can be allocated in future years. California is one of more than 30 states with some form of film incentive program. California expanded its own film tax credit in 2014 to better compete with film incentive programs in other states. However, 13 states ended their incentive programs between 2009 and 2018, which the National Conference of State Legislatures notes is part of a "larger trend of states re-evaluating or paring back film incentive programs" in which other states have also instituted or increased caps on the total subsidy that may be allocated.[53]

Since its initial enactment, some changes have been made that aim to make the credit more cost-effective. With the 2014 expansion, the allocation of the credit moved from a lottery system to a ranking process based on a production's "jobs ratio," which compares the wages to be paid to certain production staff and a portion of other production spending to the amount of the tax credit. Further, there are now penalty provisions that allow the Commission to reduce the amount of credit allowed if the jobs ratio turns out to be lower than originally specified.

For the Film Tax Credit to be considered successful, it must be inducing film production that would not have otherwise happened in California. Unfortunately, it is not known how much film production would happen in California absent the credit. According to the Commission's most recent survey of applicants who did not receive the credit found that from fiscal years 2015-16 through 2018-19, nearly one-third (32%) of production spending still occurred in California.[54] This suggests that in a significant number of cases, the Film Tax Credit is simply a windfall benefit to filmmakers who would base their production activities in California with or without the credit. Further, recent independent research on California's and other states' film incentives programs concludes that such incentives have little or no significant effects on film industry employment or wages.[55]

California Competes Tax Credit

The California Competes Tax Credit is an income tax credit meant to encourage businesses to move to or expand in California. The credit is part of a package of tax incentives that replaced the Enterprise Zone tax incentives beginning in 2014. Businesses must apply for the credit, with agreements negotiated by the Governor's Office of Business and Economic Development (GO-Biz) and approved by the California Competes Tax Credit Committee, which consists of the State Treasurer, Director of the Department of Finance, Director of GO-Biz, and one appointee each by the Speaker of the Assembly and Senate Committee on Rules. Proposals are evaluated based on criteria including the number of jobs to be created or retained, a minimum level of compensation and period of time the jobs will be retained, the training opportunities that will be provided to employees, the unemployment and poverty rates in the business development area, and how long the awardee commits to staying in California. These factors are set in a written agreement between GO-Biz and the business, and credits may be recaptured by the state if a business fails to meet the terms of the agreement. The California Competes Tax Credit currently has an allocation of $180 million per fiscal year through 2022-23, plus unallocated and recaptured credits from previous periods.[56]

These performance standards for being awarded and continuing to receive the California Competes Tax Credit are meant to help ensure that the credit succeeds in maintaining and increasing economic activity and employment in California. Certainly the criteria and review required are a step up from the Enterprise Zone hiring credits, which were an uncapped tax benefit that businesses could claim by replacing workers and reporting "new" employees on their tax return rather than applying to a commission.[57] However, an analysis by the LAO found that about 35% of California Competes credit awards – representing 15% of the total dollar value of the credit – represent windfall benefits to businesses that sell goods and services locally and do not increase the overall level of economic activity in California.[58] The LAO also notes that for the remainder of the awardees that sell goods and services outside of California, there is no way of knowing whether they would have located or expanded in the state regardless of the credit. The LAO recommended in 2017 that the Legislature end California Competes, saying that it "has similar issues inherent in other such [tax credit] programs, such as the motion picture production tax credit and the research and development tax credit. These include windfall benefits, economic inefficiency, the unequal treatment of similar taxpayers, and opportunity costs."[59]

Originally, allocations of the California Competes credit were only authorized through 2017-18, but the program was extended through 2022-23 as part of the 2018-19 budget agreement. The annual allocation was reduced from $200 million to $180 million, and GO-Biz is now required to consider "the extent to which the credit will influence the taxpayer's ability, willingness, or both, to create jobs in this state that might not otherwise be created in the state by the taxpayer or any other taxpayer" when making allocation decisions.[60] However, it is uncertain how much this requirement will limit the amount of windfall benefits in practice.

Tax Expenditures Reduce Revenues Available for Investments That May Provide Greater Public Benefit

Legislators face an inherent trade-off when enacting, expanding, or extending tax expenditures. Choosing to spend public dollars via tax expenditures means choosing *not* to spend those dollars on other services and programs that Californians need, particularly individuals and families who struggle with the costs of housing, child care, education, and other necessities. When the state gives tax breaks to corporations without a clear justification for how that spending benefits the public, or to reward wealthy families for building more wealth, those are all dollars that the state no longer has available to put to other potentially more effective uses to help Californians trying to live, work, and thrive across the state.

Those tax expenditures could be eliminated or scaled back, and the resulting revenue gains could be used to proactively invest in resources that broaden income security, wealth, and opportunity for more Californians. For example:

- California has a housing affordability crisis – more than 4 in 10 households in the state could not afford their housing costs, paying more than 30% of their income toward housing, in 2017.[61] The state's 2019-20 budget for the Department of Housing and Community Development, which provides grants and loans to support safe and affordable rental and homeownership opportunities, is $2.1 billion. The state is projected to lose nearly double this amount in revenues due to the Mortgage Interest Deduction in 2019-20 ($4.0 billion), which, as discussed earlier in this report, primarily benefits higher-income households and likely causes upward pressure on housing costs. If the deduction were scaled back, additional revenues could be dedicated to creating more affordable housing and increasing access to homeownership for individuals and families that do not currently benefit from the Mortgage Interest Deduction.

- As mentioned previously, historical racist policies and ongoing discrimination have created a profound wealth gap between white families and families of color. Nationally, median wealth for white families is more than eight times the median wealth of Latinx families and nearly ten times that of Black families. Properly-designed Children's Savings Accounts (CSAs) are one tool that can help reduce the wealth gap. CSAs are savings accounts opened for children at birth, seeded with an initial deposit by the state, which can be used for higher education costs or other asset-building opportunities. Larger initial deposits or public matches to family contributions for children from low-income or low-wealth households could reduce the racial wealth gap.[62] The 2019-20 state budget included an investment of $50 million for children's savings: $25 million in grants to local governments and organizations that sponsor CSAs, and $25 million to provide seed deposits of at least $25 into tax-preferred college savings accounts for every child born in California starting in 2020. This investment pales in comparison to the $3.2 billion that the state loses yearly by excluding accrued capital gains on inherited property from the taxable income of heirs, which largely benefits high-income households. Ending the Basis Step-Up on Inherited Property could free up significant revenue, some of which could be used for more substantial investments in CSAs and other asset-building vehicles for low-wealth children and adults.

- The high cost of child care is a barrier to economic security and opportunity for many California families. California's subsidized child care and development system is designed to serve families with low and middle incomes, but there are far more children eligible for subsidized child care than spaces funded by the state and federal governments. In 2017, 1.8 million eligible children did not have access to a subsidized child care and development program.[63] The $2.4 billion the state loses by allowing corporations to elect "Water's Edge" filing could subsidize care for more than 250,000 additional children.[64]

- People with disabilities and seniors with low incomes often have difficulties paying for housing and other living costs. Supplemental Security Income/State Supplementary Payment (SSI/SSP) grants help more than 1 million of these individuals pay for these costs, but the state portion of the grant (SSP) has been cut over the years so that the maximum combined SSI/SSP grant is now less than 90% of the federal poverty line.[65] Bringing the combined SSI/SSP grant back up to 100% of the poverty line would cost the state about $1 billion – less than the $1.3 billion that the state is projected to lose in 2019-20 from Like-Kind Exchange deferrals.[66]

- High costs of attendance and living expenses make it challenging for students from low-income households to afford college, leading many to choose between foregoing higher education and being saddled with debt. Nontraditional students that attend college more than one year after high school are not guaranteed state financial aid, and must apply for a Competitive Cal Grant. Even with the increased funding for Competitive Cal Grants in the 2019-20 budget – bringing the available awards from 25,750 to 41,000 – more than 300,000 eligible applicants do not receive assistance.[67] Extending Cal Grants to those students could cost about $775 million.[68] Meanwhile, the state is prepared to lose up to $750 million in revenues each year to Enterprise Zone replacement incentives (including the California Competes Credit, the sales tax exemption for manufacturing equipment, and the New Employment Credit) when there is no strong evidence that these incentives create new jobs in California.

These are just a few examples of how eliminating or scaling back inefficient, ineffective, and poorly targeted tax breaks that largely benefit larger corporations and wealthier households could free up revenue for policies and investments in Californians with low and middle incomes, particularly people of color. Such restructuring would turn an upside-down system of tax expenditures right-side up, help to close wealth gaps, and create opportunity for those left out of California's economic prosperity.

California's Tax Expenditure System Can Be Improved by Increasing Oversight, Evaluation, and Equity

Spending public dollars through tax expenditures is not bad in and of itself. Some tax expenditures, like the CalEITC, have worthwhile policy goals and are effective at achieving them. But California spends a lot of forgone revenues on poorly targeted tax breaks that continue to operate year to year without regular review. This often means that tax expenditure spending that primarily benefits wealthier households and businesses receives less scrutiny than spending for low- and middle-income households, much of which is overtly visible in the annual state budget.

Policymakers could improve tax expenditures by improving oversight and accountability of this less-seen avenue of public spending and by better targeting tax expenditures to individuals and businesses that are more likely to need financial assistance or incentives to engage in desired behavior.

Better Oversight and Accountability, Keeping Pace with Other States

Policymakers could improve the oversight of tax expenditures by requiring they be regularly reviewed, that they be evaluated for their effectiveness, and that the findings of such evaluations are used to inform policy decisions.

In an assessment of the practices of all 50 states in evaluating economic development tax incentives, the Pew Charitable Trusts found California to be trailing other states in its progress toward regularly evaluating incentives, appropriately measuring the fiscal and economic impacts of the incentives, and having processes in place to ensure that the evaluations inform policy choices.[69] The Department of Finance and the Franchise Tax Board produce regular reports on the estimated cost and distribution of benefits of the state's tax expenditures, and the Legislative Analyst's Office and the State Auditor's office have produced evaluations of specific tax expenditures. However, no entity is required to regularly evaluate the effectiveness of the state's tax expenditures. In contrast, by the end of 2019, nearly two-thirds of states had laws in place requiring regular evaluation of their economic development incentives, and many of these states also applied these requirements to other types of tax expenditures, such as those affecting individuals.[70]

Beyond requiring regular review, Pew's assessment identified several additional recommendations that California policymakers could adopt, including:

1. Requiring that a nonpartisan entity evaluates the effectiveness of tax expenditures;

2. Ensuring the evaluation analyzes the extent to which the tax expenditures influence behavior and considers the trade-offs the state is making by foregoing state revenue that could otherwise be spent on public services;
3. Requiring that the findings of evaluations be considered in legislative hearings where stakeholders can submit input; and
4. Setting expiration dates to encourage policymakers to consider evaluation findings when deciding whether to extend tax expenditures.[71]

Further, policymakers could consider requiring all tax expenditures to be subject to the annual budget appropriation process.[72] This would create a process by which tax expenditures receive periodic review and are considered in the context of the state's overall budget and weighed against competing policy priorities.

Policymakers have taken steps toward improving tax expenditure accountability by enacting legislation requiring that bills creating new tax expenditures include specified goals, detailed performance indicators, and data collection requirements to measure whether they are meeting their goals. Senate Bill 1335 (Leno), enacted in 2014, applied these requirements to new personal income and corporate income tax credits, but not to other types of tax expenditures. Assembly Bill 263 (Burke), enacted in 2019, extended those requirements to *all* new personal and corporate income tax expenditures and sales tax exemptions. However, these laws do not apply to existing tax expenditures. Furthermore, legislators can easily avoid including goals, performance indicators, and data collection requirements in their tax expenditure proposals by simply stating in their proposed bill language that those requirements do not apply. Legislative committee chairs have the power to enforce AB 263 by mandating that tax expenditure bills adhere to AB 263's requirements as a condition of having the bill passed out of the committee, but not every chair of a committee that hears these bills may choose to use this power.

Another bill that was passed by the Legislature in 2019 but vetoed by Governor Newsom, Senate Bill 468 (Jackson), would have temporarily created a board to make recommendations to the Legislature based on assessments conducted by the University of California of the fiscal, economic, social, and environmental effects and the cost effectiveness of certain large tax expenditures. Earlier versions of SB 468 would have set an expiration date for these expenditures, as well, so the Legislature would have had to act intentionally to preserve them. However, the sunset date provision was removed during the committee process. Notably, many tax expenditures would have been exempted from the requirements of the bill, in both early and final versions, including all personal income tax expenditures.

These efforts demonstrate steps in the right direction, but further and more aggressive action will be needed to ensure that tax expenditures are regularly evaluated, weighed against other budget priorities, and reformed or eliminated if evidence shows that they are not accomplishing their policy goals in a cost-effective manner.

Turning California's Tax Code Right-Side Up and Creating Greater Racial Equity

Policymakers could better target tax expenditures to low- and middle-income households who need help making ends meet and building a more secure future for themselves and their families. For example:

- Some itemized deductions could be replaced with tax credits, which have several advantages. Credits can be claimed by households that do not itemize, which makes them more accessible to low- and middle-income households. Credits can be set at specific amounts that provide the same level of benefit regardless of income, as opposed to deductions which provide increasing benefits as income increases. For example, a credit for first-time homebuyers would be more equitable than the existing Mortgage Interest Deduction, which provides greater benefits to higher-income households that are more likely to purchase homes anyway. Finally, credits can be made refundable so that they benefit households with incomes too low to owe personal income taxes.

- Tax expenditures that offer tax benefits to households all along the income scale could be modified so they phase out with higher income, ensuring that the state is not unnecessarily spending money on households that do not need financial aid. However, phasing out tax benefits for higher-income households would do nothing to help lower-income households that see little to no benefit from deductions and nonrefundable credits.

- Increased revenues from scaling back poorly targeted tax breaks could be used to expand existing tax benefits targeted to low- and middle-income households, such as the CalEITC and Young Child Tax Credit, and provide tax benefits that encourage savings and wealth-building among families that have experienced barriers to building wealth.

Improving the targeting of tax expenditures is one step toward the larger goal of turning the state's tax code "right-side up." This will not only mitigate after-tax income inequality, but also create greater racial equity, since tax expenditures that help boost economic security and wealth-building opportunities for low- and middle-income households – rather than making wealthy taxpayers richer – will benefit families of color, particularly Black and Latinx families, that are overrepresented in lower-income groups due to the legacy of explicitly racist policies as well as ongoing discrimination.

Given the significant loss of state revenue to tax expenditures, policymakers need to give much more consideration to whether: 1) the benefits from the tax expenditures are distributed equitably; 2) the tax expenditures are effective in accomplishing their policy goals; 3) those goals are still relevant or desirable; and 4) those goals could be more efficiently achieved through direct spending. These considerations can help inform whether to continue, reform, or end an existing tax expenditure as well as create a new tax expenditure that will reduce revenues available to support other key state priorities, such as helping Californians afford the basic costs of living, build wealth, and achieve better futures.

ENDNOTES

1 These figures represents the sums of personal income tax and corporation tax expenditures of $5 million or more. Some tax expenditures affect both personal income tax and corporation tax revenues. The Department of Finance (DOF) records estimates for these tax expenditures under the tax with the greatest estimated revenue loss. The DOF notes that these estimates are subject to more uncertainty in the wake of the federal Tax Cuts and Jobs Act, as discussed in the box on page 5. Department of Finance, *Tax Expenditure Report 2019-20*, pp. 1 and 3.

2 Nearly three-quarters (74%) of Black and Latinx households have incomes in the bottom 60% among *all* households, compared to just 56% of white households. Meanwhile, white households are three times more likely than Black and Latinx households to be in the richest 1%. Meg Wiehe, et al., *Race, Wealth, and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide* (Institute on Taxation and Economic Policy and Prosperity Now: October 11, 2018), pp. 1 and 6.

3 See Esi Hutchful, *The Racial Wealth Gap: What California Can Do About a Long-Standing Obstacle to Shared Prosperity* (California Budget & Policy Center: December 2018).

4 Note that what counts as a tax expenditure is subject to debate because "there is no absolute rule for defining tax expenditures," as the Department of Finance puts it in *Tax Expenditure Report 2019-20* (p. 1). An example of an ambiguous case is the exemption of services from the sales tax, mentioned in the box on page 15.

5 Some nonrefundable tax credits are "transferable," which means that any unused portion can be sold to another business. This allows a business that receives a nonrefundable tax credit allocation to benefit by more than the amount of their tax liability by selling the credit to another business. California's film tax credit for independent films is transferable. For more on transferable tax credits, see Josh Goodman, *Tax Breaks for Sale: Transferable Tax Credits Explained* (The Pew Charitable Trusts: December 14, 2012).

6 Budget Center analysis of Franchise Tax Board, *California Personal Income Tax Dataset B-4A: Adjusted Gross Income Class Comparison, All Filing Statuses*, retrieved from the Franchise Tax Board Open Data Portal at data.ftb.ca.gov.

7 California Budget & Policy Center, *First Look: 2019-20 Budget Includes Balanced Investments, Leaves Opportunities to Improve the Economic Well-Being of More Californians* (July 12, 2019).

8 Department of Finance, *Tax Expenditure Report 2019-20*, p. 3.

9 According to the FTB, in 2016 (the year for the FTB's latest distributional data on tax expenditures) the lower bound for the top 20% of adjusted gross income in California was $99,569. See Franchise Tax Board, *Department of Finance Exhibits Spring 2019* (May 2019), Exhibit A-12, p. 1 of 4: Lower Bound on AGI for Each Quintile.

10 For instance, discriminatory mortgage lending practices first used in the 1930s by federal agencies including the Home Owners' Loan Corporation and the Federal Housing Administration as well as private-sector lenders (often referred to as redlining), denied homeownership opportunities to many households of color. While such overtly racist practices are now illegal, housing discrimination continues to be a barrier to homeownership for people of color. For more, see Esi Hutchful, *The Racial Wealth Gap: What California Can Do About a Long-Standing Obstacle to Shared Prosperity* (California Budget & Policy Center: December 2018), pp. 4-5.

11 Esi Hutchful, *The Racial Wealth Gap: What California Can Do About a Long-Standing Obstacle to Shared Prosperity* (California Budget & Policy Center: December 2018), p. 6.

12 Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, pp. 59, 65, and 87.

13 Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, p. 19.

14 Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock, *Tax Issues Relating to Charitable Contributions and Organizations* (Congressional Research Service: September 19, 2019), p. 27.

15 See, for example, Joseph Rosenberg and Eugene Steuerle, *Reforming Charitable Tax Incentives: Assessing Evidence and Policy Options* (Urban-Brookings Tax Policy Center: November 15, 2018), and US Joint Committee on Taxation, *Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions* (February 14, 2013), pp. 48-54.

16 Urban-Brookings Tax Policy Center, *Briefing Book: What Kinds of Tax-Favored Retirement Arrangements Are There?*, Table 1: Participation in Employer-Sponsored Retirement Plans, Tax Year 2014.

17 Michelle Long, et al., *Trends in Employer-Sponsored Insurance Offer and Coverage Rates, 1999-2014* (Henry J. Kaiser Family Foundation: March 2016), p. 6.

18 Nari Rhee, *Half of California Private Sector Workers Have No Retirement Assets* (UC Berkeley Center for Labor Research and Education: July 2019), p. 5; Henry J. Kaiser Family Foundation, *Employer-Sponsored Coverage Rates for the Nonelderly by Race/Ethnicity* (Timeframe: 2017).

19 The income thresholds used for the purpose of determining how much, if any, of a household's Social Security benefits are subject to the federal income tax, are based on a households "combined income," which is the sum of adjusted gross income, nontaxable interest, and one-half of the household's Social Security benefits.

20 Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, pp. 89-90.

21 Urban-Brookings Tax Policy Center, T*able T18-0149: Tax Benefit of the Partial Exclusion of Social Security Benefits, Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2017* (October 2018).

22 Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, p. 73.

23 See, for example, Jeffrey P. Thompson and Gustavo Suarez, *Exploring the Racial Wealth Gap Using the Survey of Consumer Finances* (Federal Reserve Board of Governors: August 2015), p. 14, and Edward N. Wolff and Maury Gittleman, *Inheritances and the Distribution of Wealth Or Whatever Happened to the Great Inheritance Boom?* (U.S. Bureau of Labor Statistics Working Paper 445: January 2011).

24 Congressional Budget Office, *The Distribution of Major Tax Expenditures in the Individual Income Tax System* (May 2013), p. 15.

25 For the 2018 tax year, the phase-out occurred between "modified adjusted gross income" (generally adjusted gross income before subtracting the Student Loan Interest Deduction) of $65,000 and $80,000 for individuals, and between $135,000 and $165,000 for married couples filing jointly.

26 For more information on the Child and Dependent Care Credit, see Justin Garosi, *Options for Modifying the State Child Care Tax Credit* (Legislative Analyst's Office: April 7, 2016).

27 For more on the CalEITC and the Young Child Tax Credit, see Alissa Anderson, *The CalEITC and Young Child Tax Credit: Smart Investments to Broaden Economic Security for Californians* (California Budget & Policy Center: October 2019).

28 Franchise Tax Board, *CA Earned Income Tax Credit and Young Child Tax Credit: Expanding Help for Working Families* (September 12, 2019).

29 Franchise Tax Board, *CA Earned Income Tax Credit and Young Child Tax Credit: Expanding Help for Working Families* (September 12, 2019).

30 Alissa Anderson, *The CalEITC and Young Child Tax Credit: Smart Investments to Broaden Economic Security for Californians* (California Budget & Policy Center: October 2019), pp. 36-37.

31 California policymakers are required to specify in each year's state budget bill how large a credit to provide through the CalEITC and the Young Child Tax Credit, or else the credits will not be available for the upcoming tax year. Specifically, policymakers must specify the "earned income tax credit adjustment factor," which generally sets the state credit at a percentage of the federal EITC. This adjustment factor is also used to determine the size of the Young Child Tax Credit.

32 This estimate only includes tax expenditures that have costs exceeding $5 million. Department of Finance, *Tax Expenditure Report 2019-20*, p. 9.

33 The DOF notes that because California's "basic definition" of sales tax does not include services, they do not consider the exclusion of most services from sales taxes to be tax expenditures. See Department of Finance, *Tax Expenditure Report 2019-20*, p. 1; Board of Equalization, *Estimate of Potential Revenue to be Derived From Taxation of Currently Non-Taxable Services* (April 14, 2015). The Board of Equalization's estimate includes all untaxed services. Some argue that certain types of services should be exempt to reduce the regressivity of the tax, such as business-to-business transactions and health and education services. This would lead to lower revenue gains than the Board of Equalization estimate.

34 For more on corporate tax avoidance and worldwide combined reporting, see Richard Phillips and Nathan Proctor, *A Simple Fix for a $17 Billion Loophole* (Institute on Taxation and Economic Policy and U.S. PIRG Education Fund: 2019) and Darien Shanske, "White Paper on Eliminating the Water's Edge Election and Moving to Mandatory Worldwide Combined Reporting," *State Tax Notes* (September 17, 2018).

35 California State Auditor, *Corporate Income Tax Expenditures: The State's Regular Evaluation of Corporate Income Tax Expenditures Would Improve Their Efficiency and Effectiveness, Report 2015-127* (April 2016), p. 23.

36 Total spending on the credit for corporations was $1.5 billion in 2016. There was also a personal income tax component of the credit of about $170 million that year. Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, p. 43. This credit, like many other tax expenditures for businesses, affects personal income tax revenue because it can be claimed by "pass-through" businesses such as S corporations, partnerships, and limited liability companies that distribute their profits, deductions, and credits to their owners, who report them on their personal income taxes.

37 Because R&D activity often benefits people other than the person doing the R&D, left to their own devices, businesses will tend to do less R&D than would be ideal for society as a whole. Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, p. 44.

38 Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions, Report for 2016 Tax Year Data*, p. 45.

39 See, for instance, Andrew C. Chang, "Tax Policy Endogeneity: Evidence From R&D Tax Credits," *Economics of Innovation and New Technology* 27:8 (2018); Daniel J. Wilson, *Beggar thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D* Tax Credits (Federal Reserve Bank of San Francisco Working Paper Series: August 2007); Yonghong Wu, "The Effects of State R&D Tax Credits in Stimulating Private R&D Expenditure: A Cross-State Empirical Analysis," *Journal of Policy Analysis and Management* 24:4 (2005).

40 See, for instance, Timothy J. Bartik and Kevin Hollenbeck, *An Analysis of the Employment Effects of the Washington High Technology Business and Occupation (B&O) Tax Credit: Technical Report* (W.E. Upjohn Institute for Employment Research: June 25, 2012); Minnesota Office of the Legislative Auditor, *Minnesota Research Tax Credit: 2017 Evaluation Report* (February 2017).

41 California State Auditor, *Corporate Income Tax Expenditures: The State's Regular Evaluation of Corporate Income Tax Expenditures Would Improve Their Efficiency and Effectiveness, Report 2015-127* (April 2016), p. 20.

42 California State Auditor, *Corporate Income Tax Expenditures: The State's Regular Evaluation of Corporate Income Tax Expenditures Would Improve Their Efficiency and Effectiveness, Report 2015-127* (April 2016), p. 18.

43 Franchise Tax Board, *Department of Finance Exhibits Spring 2019* (May 2019), Exhibit B-2, p. 2.

44 Legislative Analyst's Office, *Current State R&D Tax Credits* (December 5, 2011), p. 7.

45 Corporations and pass-through businesses – as well as individuals and families if they have investment property – can take advantage of Like-Kind Exchanges, so this tax expenditure affects both corporate income tax and personal income tax revenues.

46 For corporations electing to file taxes on a Water's Edge basis, the sales factor is determined based on the portion of nationwide sales that are assigned to California. For other filers, it is based on the portion of worldwide sales assigned to California.

47 Corporations in qualified agricultural, extractive, and financial businesses are exempt from mandatory Single Sales Factor Apportionment.

48 Institute on Taxation and Economic Policy, *Corporate Income Tax Apportionment and the "Single Sales Factor"* (August 2012), p. 3.

49 Allen Prohofsky, "Revenue Estimates of California's Apportionment Formula Changes," *State Tax Notes* (August 13, 2018).

50 Chuck Marr, Chye-Ching Huang, and Joel Friedman, *Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction* (Center on Budget and Policy Priorities: February 28, 2013).

51 Calvin H. Johnson, "Impose Capital Gains Tax on Like-Kind Exchanges," *Tax Notes* (October 27, 2008), p. 476.

52 The second version of the Film Tax Credit ("Program 2.0") expires in 2020. In 2018, the tax credit was extended through 2025, and minor changes were made to the program beginning in 2020.

53 National Conference of State Legislatures, *State Film Production Incentives and Programs* (January 30, 2018).

54 California Film Commission, *Progress Report: Film and Television Tax Credit Program* (November 2019), p. 29.

55 See, for example, Patrick Button, *Do Tax Incentives Affect Business Location and Economic Development? Evidence from State Film Incentives* (National Bureau of Economic Research: June 2019); Michael Thom, "Time to Yell 'Cut?' An Evaluation of the California Film and Production Tax Credit for the Motion Picture Industry," *California Journal of Politics and Policy* 10:1 (2018); Michael Thom, "Do State Corporate Tax Incentives Create Jobs? Quasi-experimental Evidence from the Entertainment Industry," *State and Local Government Review* 51:2 (June 2019).

56 The annual allocation may be reduced in order to limit the total of the California Competes Credit and the other two Enterprise Zone replacement incentives – the manufacturing equipment sales tax exemption and the New Employment Credit – to $750 million.

57 In 2013, the LAO found that Enterprise Zone programs, of which the hiring tax credit was the most expensive, (1) were "[g]enerally not shown to be effective," (2) likely simply shifted some of the jobs created in one area away from another part of the state, and (3) likely had limited impact on statewide employment. Legislative Analyst's Office, *California's Enterprise Zone Programs* (May 9, 2013). For more on the former Enterprise Zone program, see Kristin Schumacher, *Dollar for Dollar: California's Enterprise Zone Program Falls Short* (California Budget & Policy Center: June 2013).

58 Legislative Analyst's Office, *Review of the California Competes Tax Credit* (October 31, 2017), pp. 3, 14-16.

59 Legislative Analyst's Office, *Review of the California Competes Tax Credit* (October 31, 2017), p. 17.

60 Revenue and Taxation Code, Section 17059.2(c)(7) and Section 23689(c)(7).

61 Sara Kimberlin, *California's Housing Affordability Crisis Hits Renters and Households With the Lowest Incomes the Hardest* (California Budget & Policy Center: April 2019).

62 See Laura Sullivan, et al., *Equitable Investments in the Next Generation: Designing Policies to Close the Racial Wealth Gap* (Institute on Assets and Social Policy and Prosperity Now [Formerly CFED]: 2016), pp. 9-11.

63 Kristin Schumacher, *Millions of Children Are Eligible for Subsidized Child Care, but Only a Fraction Received Services in 2017* (California Budget & Policy Center: January 2019).

64 In 2019-20, the estimated average cost for a child care space in the Alternative Payment Program is $9,251 according to a Budget Center analysis of Department of Finance data. The estimated number of child care spaces that could be subsidized with the revenues lost due to the Water's Edge Election does not take into account the costs of the infrastructure that would be required to support a large expansion of the state's subsidized child care and development system.

65 Scott Graves, *Largely Due to State Cuts, SSI/SSP Grants Have Lost More Than One-Third of Their Purchasing Power Since 1989-90* (California Budget & Policy Center: May 2019).

66 The estimated full-year cost of increasing SSI/SSP grants to 100% of the poverty line is $1.1 billion. Assembly Appropriations Committee analysis of AB 1434 (April 24, 2019).

67 Amy Rose, *Demand for Competitive Cal Grants Far Exceeds Supply* (California Budget & Policy Center: August 2019).

68 In 2019-20, the estimated average cost of a competitive Cal Grant award is $2,557, according to a Budget Center analysis of Department of Finance data.

69 The Pew Charitable Trusts, *How States Are Improving Tax Incentives for Jobs and Growth: A National Assessment of Evaluation Practices* (May 2017).

70 Josh Goodman and Shane Benz, *Governments Increasingly Rely on Evaluations for Tax Incentive Reform* (The Pew Charitable Trusts: December 18, 2019); The Pew Charitable Trusts, *How States Are Improving Tax Incentives for Jobs and Growth: A National Assessment of Evaluation Practices* (May 2017), Table 2, pp. 8-9.

71 The recommendations in the Pew Charitable Trusts assessment are specific to economic development tax incentives for businesses, but could be applied to other types of tax expenditures.

72 Currently, among California's tax expenditures, only the CalEITC and Young Child Tax Credit are subject to the annual appropriation process.