

Assessing Tax Expenditure Programs in Light of California's Fiscal Challenges

How To Assess California's Tax Expenditures and Ensure Their Effectiveness

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Tax expenditures should only be used and continued if they are an appropriate use of government resources and the best way to deliver the intended benefit.

Introduction

California's taxes, like those of the other states and U.S. government, include special rules, often referred to as "tax expenditures." Tax expenditures reduce tax liabilities and government revenues.¹ Tax expenditures tend to cause tax systems to not meet principles of good tax policy, such as equity, neutrality and simplicity. They can also make it difficult for governments to predict revenues for budget purposes. When created without a clearly articulated purpose or allowed to remain longer than needed, tax expenditures represent unnecessary spending. Because tax expenditures are not listed in any government agency's budget, the spending they represent is easily overlooked which can result in unbalanced budgets, missed opportunity to cut spending in times of budget shortfalls, and result in a jurisdiction not using or allocating resources effectively.

Yet, tax expenditures can help a jurisdiction meet its economic, societal and environmental goals. Use of the tax law to deliver certain benefits or subsidies may sometimes be more effective than creating a special program or government agency to distribute funds to particular taxpayers.

This testimony focuses primarily on how to determine if tax expenditures are effective. The tax policy and budget problems that exist with tax expenditures are noted along with suggestions on how to use accountability measures to improve the effectiveness of tax expenditures.

Outline of testimony:

- What is a tax expenditure

¹ There is also a concept of negative tax expenditures, explained later, that result in greater tax liabilities. However, most discussions about tax expenditures focus on positive ones. Positive tax expenditures far exceed negative ones in terms of both quantity and dollars.

- Why tax systems include tax expenditures
- Tax expenditure issues
- Benefits of considering the effectiveness of tax expenditures
- Determining whether tax expenditures are effective
- Accountability measures
- Suggestions to improve California's use of tax expenditures

What is a tax expenditure?

Importance of the definition: When the term "tax expenditure" is used, particularly when lawmakers are looking to repeal "tax expenditures," it is important to reach agreement on what the term means. For example, some may view a progressive rate structure of an income tax as a tax expenditure and others do not.

Basic concepts: Tax expenditures can be thought of as special rules in a tax system that are not crucial to the basic design of that tax. For example, an income tax should consist of a tax base equal to income less expenses of producing the income. A personal income tax should also include some type of personal exemption and/or standard deduction to ensure that some portion of an individual's income is not taxed because it is needed for basic living expenses. Thus, these deductions are not tax expenditures.

The word "expenditure" is used because the special rules, such as the mortgage interest deduction or an energy credit, result in reduced revenues for the government – the same result as when the government makes a direct outlay, such as a grant. Most tax expenditures or special rules could instead be direct spending by a government agency, that is, a subsidy. For example, instead of a mortgage interest deduction, the government could provide a subsidy to individuals at the time of purchase or provide a subsidy to lenders so as to allow lower interest rates for borrowers.

Not all tax expenditures though are the equivalent of a government provided subsidy, yet they still represent a special rule not required for the basic (or normal) design of a particular tax system. For example, California Revenue & Taxation Code Section 18152 allows non-corporate shareholders to exclude 50% of the gain on California qualified small business stock held over five years. This is a tax expenditure in that it is a rule not required to be in a basic income tax. It does not translate well though, to a subsidy.² A 2002 report on tax expenditures described two types of tax expenditures. One type could instead be direct government spending and the second type represented a "fiscal cost" of rules that are "departures from proper income measurement, even if they do not have an obvious programmatic spending counterpart."³

Challenges: Identifying which rules in a tax system represent tax expenditures is not always clear or consistently applied among governments or agencies within a single government. Examples of issues include the following:⁴

² The gain exclusion might be viewed as the equivalent of the shareholder obtaining a subsidy from the state to help them purchase or carry the stock, but the tax benefit is not obtained until the stock is held over five years and sold at a gain. It does not translate to a subsidy as well as most other tax expenditures, such as tax credits for purchasing certain assets or deductions for certain activities, such as making mortgage interest payments on a home.

³ Eric Toder, "Evaluating Tax Incentives as a Tool for Social and Economic Policy," essay included in *Bad Breaks All Around*, a report of The Century Foundation Working Group on Tax Expenditures, 2002, page 44.

⁴ For further information on challenges of identifying tax expenditures, see Nellen, "Rethinking the Income Tax Calculation," *AICPA Tax Insider*, 2/10/11; available at

- Distinguishing "special rules" from rules that are part of the basic design of the tax system. For example, is a progressive rate structure of a personal income tax a tax expenditure or part of the basic design? Also, is the use of the cash method by small businesses a tax expenditure or part of the design of an income tax?
- Distinguishing "special rules" from the legal foundation of the tax. For example, the California Department of Finance views non-application of sales tax to intangibles and services as not being a tax expenditure because the legal foundation of the California sales tax is a tax base consisting only of tangible personal property. In contrast, Texas includes "exclusions" in its tax expenditure report for sales tax, defining them as "transactions not taxed because they fall outside the legal definition of a taxable sale."⁵
- Should negative tax expenditures be measured and included in tax expenditure reports? A negative tax expenditure is the disallowance of something that should be part of the design of a tax. For example, denial of a deduction by businesses for certain lobbying expenditures results in higher tax payments even though the lobbying expenditure is an expense of generating business income.

Sample definitions of "tax expenditure":

- California Government Code Section 13305, which requires the Department of Finance to provide an annual tax expenditure report, defines the term as "a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state."⁶
- The California Franchise Tax Board states that "tax expenditures are deviations from normal tax law."⁷
- A 2011 report by the California Senate Office of Oversight and Outcomes refers to tax expenditures as "tax breaks" and "blank checks" that "cut taxes instead of increasing spending."⁸
- "Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 (the "Budget Act") as 'revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.' Thus, tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers."⁹
- Under New York state law, tax expenditures are defined as "features of the Tax Law that by exemption, exclusion, deduction, allowance, credit, preferential tax rate, deferral, or other statutory device, reduce the amount of taxpayers' liabilities to the State by providing either economic incentives or tax relief to particular classes of persons or entities, to achieve a public

http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2011/Tax/Tax_Calculati on.jsp.

⁵ Texas Comptroller, Tax Exemptions and Tax Incidence, Feb 2011, page 3; available at <http://www.window.state.tx.us/taxinfo/incidence/96-463TaxIncidence02-11.pdf>.

⁶ The full text of Section 13305 is included in Appendix B of this testimony.

⁷ FTB, California Income Tax Expenditures – Compendium of Individual Provisions, Dec. 2011, page 16; available at https://www.ftb.ca.gov/aboutftb/Tax_Expenditure_Report_2011.pdf.

⁸ California Senate Office of Oversight and Outcomes, Bleeding Cash: Over a Decade, Ten Tax Breaks Cost California \$6.3 Billion More than Anticipated, prepared by John Hill, Sept. 8, 2011, page 1; available at <http://sooo.senate.ca.gov/sites/sooo.senate.ca.gov/files/bleeding%20cash%20report%208%2008%2011.pdf>.

⁹ Joint Committee on Taxation, Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015 (JCS-1-12), 1/17/12, page 3; available at <http://www.jct.gov/publications.html?func=startdown&id=4386>.

purpose. This definition is less subjective than an approach that defines tax expenditures by first defining a normal tax structure because it avoids judgments about what constitutes —normal."¹⁰

- Per Stanley S. Surrey in his book *Pathways to Tax Reform* (1973, page 6): "The federal income tax system consists really of two parts: one part comprises the structural provisions necessary to implement the income tax on individual and corporate net income; the second part comprises a system of tax expenditure under which Governmental financial assistance programs are carried out through special tax provisions rather than through direct Government expenditures. This second system is grafted on to the structure of the income tax proper; it has no basic relation to that structure and is not necessary to its operation. Instead, the system of tax expenditures provides a vast subsidy apparatus and uses the mechanics of the income tax as the method of paying the subsidies. The special provisions under which this subsidy apparatus functions take a variety of forms, covering exclusions from income, exemptions, deductions, credits against tax, preferential rates of tax, and deferrals of tax."¹¹
- The report, *The Moment of Truth*, by President Obama's Deficit Reduction Panel refers to tax expenditures as "tax earmarks" and "simply spending by another name."¹²

Alternative perspectives: While most definitions of tax expenditures focus on how they represent a government outlay due to equivalence to direct spending or reduced revenues, other perspectives also exist, as described below.

- *"Loopholes":* Sometimes tax expenditures are labeled as "loopholes." In most cases though, this label is inappropriate because the provision, such as a hiring credit, is being used as intended and as provided in the tax statute. In contrast, a "loophole" describes a rule that is not carefully drafted, such that it can be used in unintended ways.
- *Whose money?:* A 1999 report of the congressional Joint Economic Committee stated: "the notion of "tax expenditures" is controversial because tax payments are viewed from the viewpoint of the government as opposed to the viewpoint of taxpayers. The "tax expenditure" concept rests on the assumption that tax rates should be applied to an expansive definition of taxpayer income so as to maximize tax revenue at any given tax rate." The report further notes that tax expenditures "are viewed as depriving the government of its rightful revenues; these lost revenues are regarded as properly belonging to the federal government. Tax provisions that shield taxpayer income, expansively defined, from exposure to prevailing income tax rates are regarded as analogous to government expenditures, hence the term, "tax expenditure." This violates the deeply ingrained principle that income, at least initially, belongs to those who generate it and that only through the democratic process becomes subject to taxation."¹³

A 1979 GAO primer on tax expenditures similarly noted that the term "tax expenditures" "carries unpleasant connotations" for some people. "The idea that the Government wants to "budget"

¹⁰ New York State Department of Taxation and Finance, *Annual Report on New York State Tax Expenditures 2011-12 State Fiscal Year*, p. 3;

<http://www.budget.ny.gov/pubs/archive/fy1112archive/eBudget1112/fy1112ter/TaxExpenditure11-12.pdf>.

¹¹ Stanley Surrey is attributed with coining the term tax expenditures in 1967 while serving as Assistant Secretary of the Treasury for Tax Policy. See Joint Committee on Taxation, *A Reconsideration Of Tax Expenditure Analysis* (JXC-37-08), May 2008, page 2; available at <http://www.jct.gov/publications.html?func=startdown&id=1196>

¹² The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, Dec. 2010, page 28; available at

http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

¹³ Joint Economic Committee, *Tax Expenditures – A Review and Analysis*, August 1999, page 1; available at <http://www.house.gov/jec/fiscal/tax/pend.pdf>.

uncollected tax monies suggests to some a confiscatory tax, as if the Government were entitled to all of a taxpayer's income."¹⁴

- *Policy tools:* A 2010 CalTaxSM article on tax policy decisions noted that the term "tax expenditure" "is now commonly used to describe a policy decision not to tax something." Such a decision is a "conscious" one "enacted with the intent to effect a specific policy goal, and thereby enhance the tax code and/or economic policy of the state."¹⁵

Why Tax Systems Include Tax Expenditures

Reasons underlying the use of tax expenditures include the following:

- To encourage certain behavior such as making charitable contributions or engaging in R&D in the taxing jurisdiction.
- To visibly provide economic development incentives to attract and retain businesses. Lawmakers often find that some type of incentive is needed to entice certain investments in the jurisdiction or to address competitive pressures due to incentives offered by other jurisdictions. In testimony before the Maryland Business Incentives in the Tax Code Subcommittee in 2009, county economic development directors offered several reasons why tax and other incentives were viewed as necessary for the state. The reasons included to help ensure the tax structure was not viewed as discouraging investment and expansion, to encourage investment in distressed communities or former Brownfield sites, to improve a company's return on investment in selecting a particular location and to better ensure that the state would be considered in a company's site selection process.¹⁶ While economic development incentives can also be provided outside of the tax system, they are likely more visible in the tax system and can easily factor in to a company's analysis comparing tax liabilities among different jurisdictions. Also, the availability of a tax break may be more assured than an incentive outside of the tax system that requires application and approval.
- To provide a government benefit where the tax system is viewed as providing an appropriate delivery vehicle. For example, the federal Earned Income Tax Credit is a social welfare program delivered through the tax system where qualified individuals can easily be identified and the benefit delivered through the IRS which already has a system in place to verify income and issue tax refunds.¹⁷ The federal government and many states have also determined that addressing the spillover effects of R&D work can be addressed easily and appropriately through a tax credit. Also, should the state want to deliver a benefit comparable to tax breaks of other states, it is generally more visible to eligible taxpayers if provided as a tax break (rather than a grant or similar benefit provided outside of the tax system).

¹⁴ GAO, *Tax Expenditures – A Primer*, PAD 80-26, page 3; available at <http://www.gao.gov/products/PAD-80-26>.

¹⁵ "Tax Policy Decisions and the California Economy," CalTax Research Bulletin, Oct. 2010, page 2; available at http://www.caltax.org/ResearchBulletin_TaxPolicyDecisionsAndTheCaliforniaEconomy.pdf. The statement likely aims to quell the often misused term "loophole" to describe some tax expenditures.

¹⁶ Nellen, "States Examining Business Tax Incentives," AICPA Corporate Taxation Insider, 6/24/10; available at http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2010/CorpTax/BusinessTaxIncentives.jsp. Maryland testimony of economic development directors of December 2009 available at <http://btrc.maryland.gov/BITCsub/archive.asp>.

¹⁷ The FTB notes that the tax expenditure approach may "be easier to administer than direct expenditures simply because the bureaucratic structure of the FTB is already in place" while creating a new agency or program to administer a direct expenditure may not be as efficient. FTB, *California Income Tax Expenditure – Compendium of Individual Provisions*, Dec. 2011, page 2011; available at https://www.ftb.ca.gov/aboutftb/tax_expenditure_report_2011.pdf.

- To help measure ability to pay, such as allowing a deduction for certain medical expenses.
- A desire by lawmakers to reduce taxes of some taxpayers in a manner other than a rate reduction, such as by providing an income tax credit or exemption for elderly taxpayers.
- To simplify the law such as by allowing small businesses to use the cash method of accounting.
- At the state level, a tax expenditure may be part of the income tax so that state law conforms to federal law.

Tax Expenditure Issues

To better understand how to make tax expenditures effective and to help assess effectiveness, it is helpful to appreciate the issues that can arise from the use of tax expenditures.

Most special deductions, exclusions, exemptions, deferrals, credits and special tax rates, create tax policy and budget problems because they entail using the tax system for other than its primary purpose of raising revenue. Yet, all is not dismal. As noted earlier, there are situations where a special tax rule can be well-designed such that the tax policy and budget issues are minimized. Understanding the types of tax policy and budget issues inherent in tax expenditures helps to illustrate how to design tax expenditures and when to use them rather than alternative methods of delivering benefits or incentives.

Tax expenditure issues are often opaque or masked because both the purpose of the special rule and alternatives for achieving that purpose outside of the tax system were not fully vetted. Also, with so many special provisions in the federal and California tax laws, many taxpayers have likely come to assume that they are a necessary element of the tax system, not realizing that alternatives often exist, such as lower tax rates or delivery of the particular subsidy by other means. These taxpayers may not even ask why a special tax rule was enacted or think to consider tax expenditures issues such as inequity and complexity.

Following is a summary of key tax policy and budget issues of tax expenditures.

Tax Policy Issues of Tax Expenditures:

- *Inequities:* Ideally, a tax system should treat similarly situated taxpayers similarly. Tax expenditures tend to violate this rule. For example, a home mortgage interest deduction only benefits homeowners with a mortgage who itemize deductions. Such individuals will have lower tax liabilities compared to individuals with similar income but no home mortgage interest. Also, special tax rules for certain industries treats such industries more favorable than other industries.

The "cost" of special tax rules in terms of reduced revenues owing to a deduction, exclusion or credit, are, in effect, paid for by other taxpayers and likely viewed as unfair by most taxpayers.

Income tax benefits in the form of deductions and exclusions favor higher income taxpayers because they are in higher tax brackets (an exception is for deductions that are not available for higher income taxpayers).

For example, assume two individuals each have a mortgage interest deduction of \$5,000. For a higher income individual with a marginal California income tax rate of 9.3%, that deduction provides a benefit of \$465. For a lower income individual with a marginal tax rate of 4%, the tax benefit of the deduction is \$200. Greater equity could be provided for many tax breaks by converting them from deductions into tax credits. Tax credits are dollar-for-dollar reductions in tax liabilities. A credit of \$50 is worth \$50 to all taxpayers regardless of their marginal tax rate. Thus, a mortgage interest tax credit equal to 5% of one's mortgage interest represents a tax savings of \$250 for both of the individuals in the prior example (who each have mortgage interest of \$5,000).

Tax credits may also favor higher income taxpayers because credits generally are not refundable (they reduce tax liability to zero with any excess credit vanishing or carrying forward to future years with no adjustment for the time value of money).

Examples: The FTB reports that the senior exemption credit and home mortgage interest deduction across income levels for 2008 tax returns was as follows.¹⁸

Senior Exemption Credit			
Adjusted Gross Income Class	Returns Reporting Credit (000's of returns)	Amount of Credit Claimed (millions of dollars)	Tax Impact of Credit (000's)
Less than \$10,000	281.8	\$33.8	\$0.0
\$10,000 - \$19,999	307.9	\$36.8	\$6.5
\$20,000 - \$49,999	551.7	\$70.8	\$42.1
\$50,000 - \$99,999	533.2	\$72.8	\$69.0
\$100,000 - \$199,999	273.3	\$39.8	\$39.2
Over \$199,999	122.2	\$17.8	\$8.3
Total	2,070.0	\$271.8	\$165.1

Mortgage Interest Deduction			
Adjusted Gross Income Class	Returns Reporting Credit (000's of returns)	Amount of Credit Claimed (millions of dollars)	Tax Impact of Credit (000,000's)
Less than \$10,000	172.2	\$3,560.3	\$2.8
\$10,000 - \$19,999	169.0	\$5,684.4	\$2.3
\$20,000 - \$49,999	954.3	\$13,436.0	\$185.4
\$50,000 - \$99,999	1,593.2	\$25,993.6	\$1,351.4
\$100,000 - \$199,999	1,305.9	\$27,254.1	\$2,334.8
Over \$199,999	497.0	\$15,467.0	\$1,344.2
Total	4,691.4	\$88,395.5	\$5,220.9

Per FTB data for 2008, 14,806,336 personal income tax returns were filed.¹⁹ Thus, 14% of returns reported a senior exemption and 31.7% reported a mortgage interest deduction. These tax benefits were claimed by less than one-third of individual taxpayers.

For the senior exemption, 28.8% of the dollar benefit went to individuals with AGI of \$100,000; 70.5% went to filers with AGI of \$50,000 or more. The mortgage interest deduction was even

¹⁸ FTB, *California Income Tax Expenditures – Compendium of Individual Provisions*, Dec. 2011, pages 49, 62 - 64; available at https://www.ftb.ca.gov/aboutftb/tax_expenditure_report_2011.pdf.

¹⁹ FTB; 2009 Annual Report—Statistical Appendix Tables, Table B-3 for resident tax returns; available at https://www.ftb.ca.gov/aboutFTB/Tax_Statistics/2009.shtml. Table B-4a.2 indicates that 4,691,424 resident tax returns for 2008 claimed a mortgage interest deduction which ties to the FTB tax expenditure table data reported above.

more skewed to higher income individuals with 70.5% of the benefit going to those with AGI of \$100,000 or more and 96.4% going to those with AGI of \$50,000 or more.

In addition to the inequity of certain deductions and credits providing a greater benefit to higher income taxpayers, the rule itself may be unfair in by providing a benefit that goes beyond the intent of the provision. The two tax expenditures noted above are good examples, as explained next.

- The senior exemption is based solely on age rather than income. Thus, it lowers the tax liability of not only low-income seniors, but also seniors who do not need a tax subsidy.
- The mortgage interest deduction applies to debt of up to \$1.1 million. It applies to debt on two homes – a principal residence and a second home, such as a vacation home. In addition to debt to acquire a principal or second home, the deduction applies to home equity debt of up to \$100,000 where the proceeds can be used for any purpose. Thus, the deduction favors individuals with the means to purchase expensive homes including a vacation home in addition to one's principal residence. Various studies on the federal mortgage interest deduction, to which California conforms, conclude that the deduction tends to encourage (and assist) higher income individuals to purchase more expensive homes.²⁰
- *Complexity*: Generally, special rules, such as for home mortgage interest or certain sales tax exemptions, add complexity to the law because of the definitions, extra calculations, recordkeeping and other special rules that are typically required to comply with the rule. For income tax provisions, complexity is often further exacerbated by disallowing use of the special rule in calculating alternative minimum tax (AMT).
- *Neutrality and Economic Efficiency*: Many special tax rules are designed to encourage particular activity such as home ownership, invest in small corporations or engage in R&D. The tax break lowers the cost of engaging in such activities, and encourage greater investment in the activities than might otherwise occur without the tax incentive. Thus, tax breaks distort decision-making. They might also harm activities that do not have tax incentive associated with them.

Special tax rules might also work in opposition to other goals of a jurisdiction. For example, the FTB observes that the Renter's Credit encourages those claiming it to continue to rent rather than buy, in opposition to the purpose of the mortgage interest deduction.²¹

- *Tax Gap*: The California Legislative Analyst's Office (LAO) notes that some tax expenditures create "serious enforcement problems" by offering "many opportunities for tax evasion, especially given the relatively low level of tax auditing the state undertakes."²²
- *Transparency*: Tax expenditures make a taxpayer's effective and marginal tax rates less obvious.
- *Appropriate Government Revenues*: It can be difficult to measure the effect (cost) of some tax expenditures making it difficult and risky to determine their impact on the budget.

²⁰ For example, see Toder, Turner, Lim and Getsinger, *Reforming the Mortgage Interest Deduction*, April 2010; available at <http://www.urban.org/uploadedpdf/412099-mortgage-deduction-reform.pdf>. The authors state that the mortgage interest deduction "disproportionately benefits taxpayers in the top fifth of the income distribution" (page 2).

²¹ FTB, *California Income Tax Expenditures – Compendium of Individual Provisions*, Dec. 2011, page 21; available at https://www.ftb.ca.gov/aboutftb/tax_expenditure_report_2011.pdf.

²² LAO, *Tax Expenditures and Revenue Options*, Presented to: Assembly Revenue and Taxation Committee, 4/7/08, page 7; http://www.lao.ca.gov/handouts/Econ/2008/Tax_Expend_04_07_08.pdf.

Budgeting Problems of Tax Expenditures:

- **Accountability:** Tax expenditures present several accountability problems. Unlike direct spending, tax expenditures are not subject to annual review in the budget process. While some tax expenditures have sunset dates, most do not. Lack of an annual review means that some special rules remain in the law even though their purpose is no longer relevant.

Insufficient data exists for most tax expenditures to enable lawmakers to determine if they are effectively meeting their purpose. In addition, the purpose of most tax expenditures is unknown. A 2011 report noted that the California Department of Finance concluded that for 70 out of 82 tax expenditures it reviewed, the legislative intent behind the expenditure was "not specified."²³

- **Transparency:** Because tax expenditure are not included in the budget, the spending they represent is easily and commonly overlooked. For example, the 2011-2012 budget items summarized below²⁴ do not include the \$3.2 billion cost of the exclusion for employer-provided health care, the \$4.3 billion cost of the mortgage interest deduction or any other tax expenditures. Thus, it is not obvious how much is truly being spent on various programs.

Enacted Budget Detail

The following table presents enacted fiscal year positions and expenditures for each agency area. These totals are comprised of State funds which include General Fund, special funds, and selected bond funds. These totals do not include federal funds, other non-governmental cost funds, or reimbursements.

State Agencies	2011-12				
	Positions	General Fund*	Special Funds*	Bond Funds*	Total State Funds*
K thru 12 Education	2,771.7	\$34,302,078	\$83,779	\$1,379,926	\$35,765,783
Higher Education	131,975.3	10,248,424	41,196	850,780	11,140,400
Health and Human Services	29,849.1	23,043,060	13,864,955	165,459	37,073,474
Corrections and Rehabilitation	64,932.3	9,821,163	24,391	-	9,845,554
Business, Transportation & Housing	42,845.6	602,591	8,042,739	5,195,395	13,840,725
Natural Resources	17,767.5	1,946,373	2,377,369	1,000,177	5,323,919
Environmental Protection	4,349.7	50,856	1,049,893	369,052	1,469,801
State and Consumer Services	15,951.3	624,225	742,731	20,206	1,387,162
Labor and Workforce Development	13,002.8	370,742	376,354	-	747,096
General Government	10,260.9	1,775,962	4,538,101	38,996	6,353,059
Legislative, Judicial, and Executive	18,089.9	3,151,385	3,038,894	339,673	6,529,952
TOTALS	351,796.1	\$85,936,859	\$34,180,402	\$9,359,664	\$129,476,925

* Dollars in thousands

- **Budget Mechanics:** Tax expenditures affect budgets differently than direct spending. In addition to the transparency and accountability issues noted above, the agency and legislative committee that have the greatest expertise in an area are likely uninvolved in the creation or review of tax expenditures. The tax expenditures are under the review of the legislative committees dealing with taxes and not those dealing with housing, education, health, etc.

²³ California Senate Office of Oversight and Outcomes, *Bleeding Cash: Over a Decade, Ten Tax Breaks Cost California \$6.3 Billion More than Anticipated*, prepared by John Hill, Sept. 8, 2011, page 4;

<http://sooo.senate.ca.gov/sites/sooo.senate.ca.gov/files/bleeding%20cash%20report%208%2008%2011.pdf>.

²⁴ Department of Finance, Governor's Budget 2011-2012; <http://2011-12.archives.ebudget.ca.gov/Enacted/agencies.html>.

While tax expenditure reports are prepared by both the Department of Finance and Franchise Tax Board, the Senate Office of Oversight and Outcomes notes that they are not used in the budget-making process.²⁵

Tax expenditures and budgets are created by simple majority vote. However, a two-thirds vote is required to repeal a tax expenditure because it results in a tax increase. In contrast, to remove spending from a budget, only a simple majority vote is required.

Finally, the cost of tax expenditures is not as easy to control as a direct funding allocation to an agency. For example, the Department of Housing & Community Development is allocated a fixed budget amount. In contrast, there is no limit on how many people may claim the mortgage interest deduction. While some tax expenditures have aggregate caps, such as the jobs credit (R&T Sections 17053.80 and 23623), most do not. A 2011 Senate report noted the problem well in its title – *Bleeding Cash: Over a Decade, Ten Tax Breaks Cost California \$6.3 Billion More than Anticipated*.²⁶

- *Inefficient Use of Resources*: Lack of sufficient and regular review of tax expenditures increases the likelihood that they are not effectively using resources. Some tax provisions are not targeted well to the type of activities or taxpayers they are intended to benefit. For example, the California senior exemption applies to many senior citizens with income well above the poverty level. The sales tax exemption for food exists because food is a necessity of life. However, higher income individuals spend more on food than do others so they reap a greater benefit from this exemption as it covers their food beyond the cost of food constituting a basic necessity. Lack of accountability and regular analysis prevents knowing whether the \$3.8 billion cost²⁷ of the food exemption might be better targeted at helping low-income taxpayers if replaced with a refundable income tax credit or direct subsidy that would only go to those in need.

The employee exclusion for the value of health insurance provided by an employer provides a great benefit to high-income employees as they may receive a larger benefit from their employer and the exclusion is worth more to them because they are in a high tax bracket. The \$3.2 billion cost²⁸ of this tax expenditure that only benefits employees might better serve the state if it could be spread among more taxpayers, particularly those without employer-provided health insurance.

President Bush's Advisory Panel on Federal Tax Reform noted in its 2005 report that the health insurance exclusion likely increased the cost of health care. The exclusion "creates incentives that lead to inefficiencies in the market for health care. Because of the tax-preferred status of health insurance, people are more likely to buy health insurance that provides more coverage than they would in the absence of the incentive. Workers who purchase more health insurance may, in turn, use more health services, thereby increasing overall health spending. Estimates are imprecise, but removing subsidies for employer-provided health insurance could lower private spending on healthcare by 5 to 20 percent. In addition, these tax subsidies for higher-income taxpayers may raise premiums for lower-income people thereby increasing the number of uninsured Americans. Ultimately, the tax treatment worsens disparities in insurance coverage, in use of care, and potentially in health outcomes."²⁹

²⁵ *Bleeding Cash, supra*, page 3.

²⁶ *Bleeding Cash, supra*.

²⁷ Per the Department of Revenue estimate for 2011-12.

²⁸ Per the Department of Revenue estimate for 2011-12.

²⁹ President's Advisory Panel on Federal Tax Reform, Final Report, Dec. 2005, page 80; available at <http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html/>

Benefits of Considering the Effectiveness of Tax Expenditures

"Tax expenditure analysis can help both policymakers and the public to understand the actual size of government, the uses to which government resources are put, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation."
[Joint Committee on Taxation]³⁰

A business that implements a new marketing approach or advertising campaign or structures a compensation package for an executive, will use accountability measures to be sure it is getting the desired benefit, knows the return on investment (ROI), and makes sure the costs reap the best return for the company. For the same reasons, accountability measures are appropriate for government spending, including for tax expenditures.

Considering the effectiveness of tax expenditures, both prior to enactment and after enactment, will help the taxing jurisdiction get the best benefit from its resources. Such evaluation can also help ensure that tax expenditures are designed to best meet principles of good tax policy. Evaluation can also ensure that revenues do not continue to be spent on outdated tax expenditures or ones not carefully crafted to help the jurisdiction achieve its goals.

Improving Effectiveness of Tax Expenditures

The following questions can help improve the effectiveness of proposed tax expenditures. To illustrate the question, it is applied to a proposal to provide a credit to students who prepare to teach STEM topics (science, technology, engineering and math).

1. *Jurisdiction's Goals and Strategy*: Have the jurisdiction's economic, societal and environmental goals been identified and articulated? To help determine if the purpose of a tax expenditure is appropriate, it must be judged by how well it helps the jurisdiction meet its goals. Thus, such goals need to be articulated. In addition, answers should be provided as to why the tax expenditure is the necessary and desired way to help achieve the goal and why alternative uses of the funds would not be better.

Example: What is the California goal that will be advanced by the tax credit? How will the credit help the state meet the goal – what is the connection between the program and the goal?

2. *Tax System Relevance*: (A) Does the tax system hinder the jurisdiction's achievement of the goal such that modification (the addition of special rule) is needed to help the jurisdiction meet its goals? OR (B) Would the tax system be an effective and appropriate vehicle for delivering the benefit? What are the pros and cons of using the tax system to provide the incentive compared to alternative means (such as a grant)?

Example: It is unlikely that there is any tax system feature that hinders students preparing for STEM topics. Thus the question is whether the tax system is an effective and appropriate vehicle for delivering the benefit. Arguably, it is not because the FTB would have to gather information on the student's courses and major. Also, unless refundable, the credit would only be obtained if the student had a tax liability. In addition, the credit would not be delivered when needed, that is, when tuition is due. A grant program could better deliver the benefit, assuming the benefit is needed to help the state meet its goals.

³⁰ Joint Committee on Taxation, *Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates* (JCX-15-11), Feb. 28, 2011, page 1; available at <http://www.jct.gov/publications.html?func=startdown&id=3740>.

3. *Tax Policy Considerations:* Principles of tax policy, including equity, simplicity, neutrality and efficiency, minimum tax gap and transparency should be considered in the design of the tax expenditure.

Example: Measures would be needed to be sure the student is actually preparing to become a STEM teacher. Issues would need to be addressed as to whether the credit should be refundable and whether a student claimed as a dependent should be eligible.

4. *Budget Considerations:* What is the estimated direct and indirect costs of the special tax rule? How long should the tax rule be in effect? How will the cost be controlled (such as setting an aggregate limit for a tax credit)? Will the method of paying for the special rule hinder the ability of the special rule to meet its purpose or cause a greater detriment to the jurisdiction than would occur in absence of the special rule? Could greater benefits be derived for the jurisdiction through other uses of the funds (even if for a different purpose)?

Example: Legislators need an answer to the question – Why is this credit a good use of state resources? Data would need to be analyzed to determine how much the credit should be to serve as an incentive and an aggregate cap determined and implemented. Consideration should also be given to how the credit affects existing grant programs for higher education to be sure there is no duplication. In addition, consideration is needed as to whether more resources will need to be directed to STEM instruction to ensure that the expected increase in number of STEM students can be served. Alternative uses of the funds should be evaluated to construct the best program to help the state meet its goal of increasing the number of STEM teachers.

5. *Accountability Measures:* What accountability measures should be included to ensure that the special tax rule is properly used? (See examples of commonly used accountability measures in the next section.)

Example: Consideration should be given to including a clawback measure should a student not become a STEM teacher. A sunset date should be added to ensure that the credit will be evaluated for effectiveness.

6. *Assessment:* What data is needed to determine if the special tax rule achieves its purpose? How and when will the data be collected? Should the enacting legislation also specify data collection requirements? Who will monitor collection and who will analyze the data?

Example: The enacting legislation should specify the data that is needed for evaluation purposes and who will collect it and how. The enacting legislation should also specify a measurable and appropriate goal, such as a percentage increase in the number of STEM teachers who utilized the credit.

This set of questions can also be modified to evaluate existing tax expenditures. Such an analysis should help indicate where tax expenditures may have outlived their original purpose, are overly broad (poorly targeted), are inequitable, are complex, use scarce resources that could instead be used to lower tax rates and/or provide an alternative benefit that would better help the state meets its goals, and where accountability measures are lacking. Appendix A includes an analysis where the six questions are applied to the mortgage interest deduction.

Accountability Measures

There are various accountability measures that can be used in the design and operation of tax expenditures to best ensure they are working as intended. The chart on the next page lists commonly used accountability measures and their pros and cons. The approaches listed can usually be used in combination. For example, specific qualifications to use a special tax rule can be used along with clawback provisions whereby the taxpayer must recapture (payback) all or some portion of the tax break

if the specified requirement (such as hiring workers who remain on the taxpayer's payroll for over one year) is not satisfied. In addition, a sunset provision can be included to ensure that the special tax rule is reviewed by lawmakers, and a public report on the use and effectiveness of the special tax rule can be created to help lawmakers and help the public understand the tax system and budget results better.

EXHIBIT 1 Advantages and Disadvantages of Various Types of Accountability Measures		
Type of Measure	Advantages	Disadvantages
Specificity of qualifications	<ul style="list-style-type: none"> • Businesses know up front what they need to do to qualify for the incentive. • For tax incentives, the regular audit processes of a jurisdiction's tax agency can verify compliance. • Drafting of the qualifications should lead lawmakers to consider the goals of the particular incentive. • May involve a reporting form to help the business know if it qualifies for the incentive. The form may be useful for reporting and disclosure purposes. 	<ul style="list-style-type: none"> • For tax incentives, accountability through specificity of qualifications may lead to audit difficulties for tax agencies if the qualifications involve areas that are not normally part of a tax audit or within the auditor's expertise.
Approval process	<ul style="list-style-type: none"> • Provides an opportunity for the granting agency to obtain all of the information needed to determine if a business qualifies for an incentive. • Enables a business to know up front that it is eligible for the incentive. 	<ul style="list-style-type: none"> • Can cause a delay in granting the incentive. • The process may be expensive, although a fee can be charged to offset some of the cost. • May require additional employees or processes.
Monitoring	<ul style="list-style-type: none"> • Can catch compliance and eligibility problems early. • Can enable data to be collected that may be useful in evaluating the need for funding or qualification changes. 	<ul style="list-style-type: none"> • Can be expensive and require additional employees and processes.
Clawbacks and similar techniques	<ul style="list-style-type: none"> • Allows the business to get the funds up front when needed. • Can include interest and/or a penalty to compensate the state for the time-value of money. • Can help the jurisdiction meet its goals by making additional funds available for businesses that will meet the specified goals. 	<ul style="list-style-type: none"> • Repayment of funds already spent can cause hardship to the company and its employees and suppliers, although waiver provisions may alleviate some of this hardship. • Requires some type of monitoring and reporting system to identify when disqualification occurs.
Sunsets	<ul style="list-style-type: none"> • For tax incentives, allows for an opportunity to evaluate the effectiveness of the incentive. • Sends a clear message to businesses as to when action must be taken to receive the incentive, although deadlines can be specified in other measures as well. 	<ul style="list-style-type: none"> • Sunset provisions do not always call for the collection of data, which would help with the evaluation of the incentive. • May allow an ineffective incentive to remain in operation longer than it should.
Public disclosure	<ul style="list-style-type: none"> • Provides information to all stakeholders to help them better understand a jurisdiction's budget and economic development plans. 	<ul style="list-style-type: none"> • May be a deterrent to some businesses' applying for incentives. • May not provide enough details to show how the funds benefited the jurisdiction.
Analysis for stakeholders	<ul style="list-style-type: none"> • Allows for a higher level and broader review of incentives, rather than looking only at each type of grant, tax expenditure, and other incentives in isolation. • Should allow for analysis of how a jurisdiction's budget, tax system, and economic development strategies need to work together for the benefit of all stakeholders. • Allows for more information to be made available to the public. 	<ul style="list-style-type: none"> • Can be time-consuming and costly to prepare. • May not provide meaningful information if the goals for programs are not clearly articulated or easily measured.

Source: Nellen, "Accountability in the Incentives Process," *Journal of Multistate Taxation and Incentives*, June 2009, page 23.

Recent accountability proposals: SB 364 and SB 508 proposed new accountability measures for tax expenditures. Both proposals passed in 2011, but were vetoed by Governor Brown in October 2011.

SB 364 would have imposed a penalty for future credits enacted, where the claimant had a decrease in employment. While a clawback can be an appropriate accountability measure, a limitation of the proposals was that it would have increased complexity due to measuring employment and identifying which future credits would be subject to the penalty. In addition, a clawback should tie to the particular credit. It would be more appropriate to design accountability measures for each particular tax expenditure.

SB 508 would have authorized "a personal income or corporation tax credit to contain, among other provisions, (1) specified goals, purposes, and objectives that the tax credit will achieve, (2) detailed performance indicators to measure whether the tax credit is meeting those goals, purposes, and objectives, and (3) a requirement that the tax credit cease to be operative 7 taxable years after its effective date, as specified."

The SB 508 accountability measures are appropriate ones that would not only allow for an analysis of covered tax expenditures, but might also prevent unnecessary tax expenditures from being added to the income tax. However, the proposal had limitations such as only addressing credits in the personal and corporate income tax. Tax expenditures also come in the form of deductions, exclusions and deferrals, and exist in all types of taxes.

Suggestions to Improve California's Use of Tax Expenditures

- Avoid enacting tax expenditures unless it is truly evident that doing so achieves an articulated state goal and that a tax expenditure is a better approach than direct funding and the tax expenditure will not have hidden costs or adverse affects on other taxpayers or activities or hinder other state goals.
- Follow the approach used in Texas and require the Department of Finance tax expenditure report to include items excluded from the sales tax that represent consumption but are not tangible personal property (such as services and digital goods). Require the Department of Finance to also separately report sales tax expenditures for business purchases and personal purchases.³¹
- Require any new tax expenditure proposals to address some form of the six effectiveness questions described earlier in this testimony. The legislation should state why the special tax rule is needed to help the state meet a specified goal, why the rule is better than an overall tax rate reduction, why non-tax alternatives are not pursued, which taxpayers will benefit and their income level, and the direct and indirect costs.
- Enact accountability measures for any new tax expenditure. The enacting legislation should also specify what data is needed to enable a review of the rule's effectiveness and how the data will be collected and analyzed.
- To help address tax law complexity, enact a rule that new tax breaks cannot be enacted without also cutting back on some other tax break unless specified criteria are satisfied.
- Bear in mind that just because the federal government has a special tax break, California might not also need to have it.
- If any tax expenditure is to be reduced or repealed, provide a transition period for a phase-out to lessen the adverse impact to affected taxpayers.

³¹ Arguably, there should be no tax expenditures for purchases by businesses because a consumption tax should not include business purchases in order to avoid pyramiding. That is, a normal sales tax would not tax business purchases.

- To best meet principles of good tax policy, strive for a tax with a broader base and lower rates. Encourage Congress to make similar changes to the federal tax law to make it easier to reduce the number of tax expenditures in the California income and franchise tax.
- Create a "unified budget" that includes both direct spending and the spending that is part of the tax law (tax expenditures). A 1979 GAO report noted the benefits of such a comprehensive analysis: "Identifying [the effects of tax expenditures] as subsidies is exactly the reason for constructing tax expenditures budgets. By lumping together the total Government support for an activity, including direct payments, loans, loan guarantees, and tax expenditures, it is possible to evaluate that support in ways that might not otherwise be apparent. One type of support may be far more (or less) effective than others, leading to a restructuring of the support. The effects of the tax expenditure may conflict with the goals of the direct payment programs, and hence one or the other should be changed. It might be that the existence of one type of program makes another redundant. Both tax expenditure and direct expenditure policies can benefit from this type of analysis."³²
- Create a permanent commission to regularly analyze existing tax expenditures including determining the purpose of the provision. The commission could propose appropriate accountability measures for existing expenditures. It could also provide annual reports on selected expenditures. These reports would help the legislature to identify where improvements are needed. The reports would also help educate the public on the pros and cons of various special tax rules. This may lead to greater support for reducing or repealing poorly targeted, outdated and inefficient tax rules, even popular ones. A few states have such commissions, such as Oklahoma's Incentive Review Committee.³³

Resources

- California Board of Equalization, *Sales and Use Taxes: Exemptions and Exclusions*, Publication 61, June 2010; <http://www.boe.ca.gov/pdf/pub61.pdf>.
- California Department of Finance, *Tax Expenditure Report 2011-12*; http://www.dof.ca.gov/research/documents/Tax_ExpenditureRpt_11-12-Web.pdf.
- California Franchise Tax Board, *Income Tax Expenditures*, Dec. 2011; https://www.ftb.ca.gov/aboutftb/Tax_Expenditure_Report_2011.pdf.
- California Senate Office of Oversight and Outcomes, *Bleeding Cash: Over a Decade, Ten Tax Breaks Cost California \$6.3 Billion More than Anticipated*, prepared by John Hill, Sept. 8, 2011; <http://sooo.senate.ca.gov/sites/sooo.senate.ca.gov/files/bleeding%20cash%20report%208%2008%2011.pdf>.
- Government Accountability Office, *Tax Expenditures – A Primer*, PAD 80-26; <http://www.gao.gov/products/PAD-80-26>.
- Government Accountability Office, *Tax Policy – Tax Expenditures Deserve More Scrutiny*, GAO/GGD/AIMD-94-122, June 1994; <http://www.gao.gov/products/GGD/AIMD-94-122>.
- Joint Committee on Taxation, tax expenditure reports; <http://www.jct.gov/publications.html?func=select&id=5/>
- LAO, *Tax Expenditures and Revenue Options*, Presented to: Assembly Revenue and Taxation Committee, 4/7/08; http://www.lao.ca.gov/handouts/Econ/2008/Tax_Expend_04_07_08.pdf.
- The Century Foundation, *Bad Breaks All Around*, 2002.
- The Pew Charitable Trusts, Subsidy Scope website; <http://subsidyscope.org/>.

³² GAO, *Tax Expenditures – A Primer*, PAD 80-26, page 2; available at <http://www.gao.gov/products/PAD-80-26>.

³³ Information available from the Oklahoma Department of Commerce at <http://www.okcommerce.gov/Data-And-Research/Downloads/Incentive-Review-Committee-IRC>.

Appendix A
Sample Effectiveness Analysis

Analysis Criteria	Mortgage Interest Deduction (personal income tax)
<p>1. <i>Jurisdiction's Goals and Strategy:</i> Have the jurisdiction's economic, societal and environmental goals been identified and articulated? To help determine if the purpose of a tax expenditure is appropriate, it must be judged by how well it helps the jurisdiction meet its goals. Thus, such goals need to be articulated.</p>	<p>The goal of this expenditure is to encourage home ownership and strengthen communities. However, the rule also encourages debt (up to \$1.1 million). Might the state's goals be better met by providing a grant to assist with purchase of a home, with the amount based on need?</p> <p>What data does the state have on home ownership rates and whether aided by the deduction (only one-third of individuals itemize deductions).</p> <p>How does the deduction affect the construction industry and property values?</p>
<p>2. <i>Tax System Relevance:</i> (A) Does the tax system hinder the jurisdiction's achievement of the goal such that modification (the addition of special rule) is needed to help the jurisdiction meet its goals? OR (B) Would the tax system be an effective and appropriate vehicle for delivering the benefit? What are the pros and cons of using the tax system to provide the incentive compared to alternative means (such as a grant)?</p>	<p>The tax system likely does not hinder home purchases. Delivery of this benefit via a deduction creates an upside-down subsidy in that higher income individuals receive a greater benefit. This could be remedied by using a credit rather than a deduction.</p> <p>Subsidies could instead be delivered at the time of purchase or through a property tax exemption.</p>
<p>3. <i>Tax Policy Considerations:</i> Principles of tax policy, including equity, simplicity, neutrality and efficiency, minimum tax gap and transparency should be considered in the design of the tax expenditure.</p>	<p>The deduction provides a larger subsidy to higher bracket taxpayers. Favorable tax treatment of homes may lead to reduced investment elsewhere which may adversely affect the economy. The home equity loan provision adds some complexity to the law.</p> <p>The home equity loan interest deduction is unfair in that it provides a tax-favored lending scheme for homeowners with equity that is not available to others. For example, if a homeowner borrows against their home to buy a car, the interest is deductible. An individual who borrows from the dealer to buy the car may not deduct the interest expense.</p>
<p>4. <i>Budget Considerations:</i> What is the estimated direct and indirect costs of the special tax rule? How long should the tax rule be in effect? How will the cost be controlled (such as setting an aggregate limit for a tax credit)? Will the method of paying for the special rule hinder the ability</p>	<p>There are no cost controls on this tax expenditure.</p> <p>Would California and taxpayers be better served with a lower rate and no mortgage interest deduction (borrowers would still have a federal tax deduction)? Could the budget resources freed up be better used to help communities and encourage home ownership among a broader group of individuals?</p>

<p>of the special rule to meet its purpose or cause a greater detriment to the jurisdiction than would occur in absence of the special rule? Could greater benefits be derived for the jurisdiction through other uses of the funds (even if for a different purpose)?</p>	
<p>5. <i>Accountability Measures:</i> What accountability measures should be included to ensure that the special tax rule is properly used? (See examples of commonly used accountability measures in the next section.)</p>	<p>The only accountability measure is in the basic design of the deduction and its dollar limits and definitions.</p>
<p>6. <i>Assessment:</i> What data is needed to determine if the special tax rule achieves its purpose? How and when will the data be collected? Should the enacting legislation also specify data collection requirements? Who will monitor collection and who will analyze the data?</p>	<p>Data on how many people are able to purchase a home only because of the mortgage deduction rule is needed. Data would be useful to help assess how the dollar limits can be reduced to tie better to median home prices. Data on the effect of favorable home equity loans on debt/equity ratios, foreclosures and bankruptcy would be useful.</p>

Appendix B
California Government Code Section 13305

- (a) The department shall provide an annual report to the Legislature on tax expenditures by no later than September 15 of each year. The report shall include each of the following:
- (1) A comprehensive list of tax expenditures exceeding five million dollars (\$5,000,000) in annual cost.
 - (2) The statutory authority for each credit, deduction, exclusion, exemption, or any other tax benefit as provided by state law.
 - (3) A description of the legislative intent for each tax expenditure, if the act adding or amending the expenditure contains legislative findings and declarations of that intent, or that legislative intent is otherwise expressed or specified by that act.
 - (4) The sunset date of each credit, deduction, exclusion, exemption, or any other tax benefit as provided by state law, if applicable.
 - (5) A brief description of the beneficiaries of the credit, deduction, exclusion, exemption, or other tax benefit as provided by state law.
 - (6) An estimate or range of estimates for the state and local revenue loss for the current fiscal year and the two subsequent fiscal years. For sales and use tax expenditures, this would include partial year exemptions and all other tax expenditures when the State Board of Equalization has obtained that information.
 - (7) For personal income tax expenditures, the number of taxpayers affected and returns filed, as applicable, for the most recent tax year for which full year data is available.
 - (8) For corporation tax and sales and use tax expenditures, the number of returns filed or business entities affected, as applicable, for the most recent tax year for which full year data is available.
 - (9) A listing of any comparable federal tax benefit, if any.
 - (10) A description of any tax expenditure evaluation or compilation of information completed by any state agency since the last report made under this section.
- (b) For purposes of this section, "tax expenditure" means a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state.
- (c) This section shall become operative on January 1, 2007.