



*Tax*

EXPENDITURE  
REPORT

2007-08



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## INTRODUCTION

The Department of Finance has been required to provide a tax expenditure report to the Legislature since 1971. Chapter 1762, Statutes of 1971, required that a biennial report be submitted to the Legislature. Chapter 268, Statutes of 1984, increased the reporting frequency from once every two years to once a year. Chapter 49, Statutes of 2006, required the report to include each of the following:

- A comprehensive list of tax expenditures exceeding \$5 million.
- The statutory authority for each provision.
- A description of the legislative intent of each, if specified in the enacting legislation.
- The sunset date of each provision.
- The beneficiaries of the provision.
- An estimate of the state and local revenue loss for the current and two subsequent fiscal years.
- For personal income tax expenditures, the number of taxpayers and returns affected for the most recent tax year.
- For corporation and sales tax expenditures, the number of returns or businesses affected for the most recent year for which data is available.
- A listing of any comparable federal benefit.
- A description of any tax expenditure evaluation or compilation of information completed by any state agency since the last tax expenditure report by the Department of Finance.

This report fulfills the Department's statutory requirement pursuant to Government Code Section 13305.

## DEFINITIONS

There is no absolute rule for defining tax expenditures, and the concept of a "tax expenditure" can be defined in several different ways. Section 13305 defines tax expenditure as "a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state."

Although broad, this definition does exclude several provisions of the tax law from classification as tax expenditures.

- Because the basic structure of each tax is used as the starting point for determining what constitutes a tax expenditure, elements of the basic tax structure that exempt certain groups are not considered tax expenditures. For example, the sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. According to its basic definition, California's sales tax does not apply to sales or leases of real property, sales of services, wholesale transactions, or sales of securities and insurance. These exemptions are therefore not considered tax expenditures. They are elements of the basic tax structure.
- Across-the-board tax rate reductions do not represent tax expenditures. Tax expenditures resulting from changes in the rate structure only exist if different sets of rates are applied to a similar base.
- Progressive rate structures do not constitute tax expenditures. The basic structure of California's income tax is progressive. For that reason, application of different tax rates to different income levels is a basic characteristic of the tax and does not represent a tax expenditure.
- Exemptions or exclusions required by the U.S. Constitution, the California Constitution, or federal laws are not considered tax expenditures.
- Changes in tax law that alter penalties or interest or that accelerate or defer tax payments are generally not considered tax expenditures unless they are very narrowly targeted.

However, the definition of "tax expenditure" is subject to debate, and there is no single rule for determining what constitutes an element of the basic tax structure. For this reason, this report may exclude items that are included in other tax expenditure reports and vice versa.

## WHY ADOPT TAX EXPENDITURES

Tax expenditures may be classified into the following four broad groups:

- Those which conform California tax law to federal provisions.
- Those intended to remove perceived inequities in the basic tax structure.
- Those intended to ease tax administration.
- Those which grant targeted tax reductions through exemptions, credits, deductions, or exclusions.

There are several differences between tax expenditures and direct expenditures

(those authorized through the budget process). First, tax expenditures are reviewed less frequently than direct expenditures once they are in place. This can offer taxpayers more certainty than if tax expenditures were subject to annual review, but can also result in tax expenditures remaining in the tax code long after outliving usefulness.

In general, there is also no control over the amount of foregone revenue that results from a tax expenditure once that provision has become part of the tax code. Finally, the vote requirements for tax expenditures and direct expenditures are different. Tax expenditures that are adopted legislatively (except those adopted as urgency measures) require approval by a simple majority of both houses of the Legislature. A two-thirds vote is required for budgetary appropriations.

## REVENUE ESTIMATES

The estimates listed in this report are intended as a general indication of revenue losses from tax expenditure programs. In general, revenue estimates for the Personal Income Tax and Corporation Tax Laws are easier to quantify than those for the Sales and Use Tax Law. Personal income and corporation tax returns contain significant detail regarding different sources of income and types of exemptions, exclusions, deductions, and credits claimed. Thus, tax return data are often available when estimating the fiscal impact of various income and corporation tax expenditure programs. In contrast, returns filed by taxpayers under the Sales and Use Tax Law contain little specific information regarding items purchased from individual retailers. For this reason, independent data sources must be used when estimating the revenue impacts of various sales tax expenditure programs, and the precision of these estimates can be lower than those for the Personal Income Tax and Corporation Tax Laws.

In addition, certain estimates under all of the tax laws for which tax expenditure costs are cited can be subject to significant margins of error due to data limitations. Other factors complicating this report's estimates include the effects of tax law interactions and taxpayer reactions to changes in tax law. Therefore, while the report displays the total value of the major identified expenditures within each major tax, these figures are best viewed as illustrative only. The fiscal impact of individual tax expenditures cannot be summed to generate the total fiscal impact of all tax expenditures due to the complicating factors of tax law interactions and taxpayer behavioral responses.

With the exception of the deduction for charitable contributions, the revenue loss for tax expenditures that are included in both Corporate and Personal Income Tax Laws are shown under the tax with the greatest revenue loss. For Subchapter S corporation treatment, the revenue gain under the personal income tax is netted against the loss for the corporation tax and the result is shown under the corporation tax.

## STATE REVENUE LOSSES

**Personal Income Tax** The Personal Income Tax Law includes the vast majority of all tax expenditure programs approved to date. It is estimated that special income tax provisions account for approximately \$37 billion in annual tax expenditures.

**Sales and Use Tax** The Sales and Use Tax Law contains identifiable state tax expenditures worth about \$9 billion annually. Examples of these include food; prescription medicines; gas, electricity, and water delivered through mains; farm equipment; fuel sold to common carriers; and rental of linen supplies.

**Corporation Tax** Tax expenditures in the corporation category amount to about \$4 billion annually. Examples of these expenditures include provisions for S corporations, water's edge election, provisions for research and development, and special treatment for economically depressed areas.

**Other Taxes** Remaining tax laws are estimated to contain tax expenditure programs valued at more than \$100 million. Much of this revenue loss results from aircraft jet fuel and motor vehicle fuel tax expenditures.

## LOCAL REVENUE LOSSES

The revenue losses to local governments are also shown for the sales tax and the property tax. Property taxes are local taxes, and the legislative exemptions or preferential provisions do not constitute state tax expenditures. Nonetheless, they impact state finances because local tax exemptions reduce property tax allocations to schools. Under school finance law, the state is generally required to provide the difference in funding between local property tax allocations and school districts' revenue limits. Consequently, each dollar of property tax revenue foregone by schools results in additional state funding through the school apportionment process. Passage of Proposition 98 in November 1988 further impacts state school financing by establishing minimum funding levels for public schools and community colleges, based on both property taxes and state funding under what are known as the Test 2 and 3 formulas. However, under Test 1, property taxes allocated to schools and community colleges are not part of the guaranteed funding level.

Local government revenue losses from identifiable property tax exemptions are estimated to be in excess of \$100 million, while losses from sales tax expenditures are estimated to be almost \$5 billion.

## UNIDENTIFIABLE REVENUE LOSS AREAS

It is not always possible to quantify the revenue loss of a particular tax expenditure. Fortunately, in most instances, those tax expenditures whose revenue impact cannot be estimated represent unique situations and probably do not result in significant revenue losses. Some examples of tax expenditures for which revenue losses cannot be quantified include sales tax exemptions for livestock and for meals furnished by institutions, and property tax exemptions for intangibles and air carrier ground time.

## LEGISLATIVE INTENT

This report includes the legislative intent of the tax expenditure when that intent was specified in the enacting or amending legislation.

## OTHER TAX EXPENDITURE REPORTS

In August of 2006, the Franchise Tax Board released an update of their report, *California Income Tax Expenditures, Compendium of Individual Provisions*, covering personal income tax and corporation tax expenditures.

The Board of Equalization released Publication 61 in June of 2005 entitled *Sales and Use Taxes: Exemptions and Exclusions*.

*The 2007-08 Budget Perspectives and Issues* prepared by the Legislative Analyst's Office included an evaluation of the Governor's Budget proposals to eliminate the Teacher Retention Credit and make permanent the one-year test for use tax on vehicles, vessels, and aircraft.

		State General Fund Revenue Loss				
		2005-06 <sup>a</sup>	2006-07 <sup>b</sup>	2007-08 <sup>b</sup>	2008-09 <sup>b</sup>	2009-10 <sup>b</sup>
<b>Personal Income Tax</b>						
	<b>Provision</b>					
	Home mortgage interest deduction	\$4,475	\$4,860	\$5,255	\$5,695	\$6,185
	Exclusion of employer pension contributions	4,224	4,450	4,686	4,905	5,144
	Exclusion of employer contributions to health plans	2,888	3,161	3,442	3,690	3,944
	Exclusion of capital gains on sale of principal residence	3,343	3,484	3,606	3,683	3,779
	Basis step-up on inherited property	2,970	3,030	3,095	3,170	3,250
	Exclusion of Social Security benefits	1,505	1,600	1,669	1,735	1,814
	Charitable contributions deduction <sup>1</sup>	1,420	1,475	1,520	1,570	1,640
	Exclusion of benefits provided under cafeteria plans	1,120	1,230	1,345	1,470	1,610
	Real estate deduction	1,189	1,232	1,253	1,262	1,278
	Exclusion of investment income on life insurance and annuity contracts	1,140	1,170	1,200	1,230	1,260
	Dependent exemption in excess of personal exemption credit	1,034	1,084	1,122	1,160	1,201
	Employee business and miscellaneous expenses deduction	720	760	800	845	895
	Contributions to IRAs deduction	445	530	625	685	750
	Head-of-household and qualifying widower filing status	675	685	700	710	720
	Depreciation beyond economic depreciation	630	615	570	585	595
	Contributions to self-employed retirement plans deduction	380	410	440	460	475
	Exclusion of miscellaneous fringe benefits	270	280	285	295	310
	Medical and dental expenses deduction	246	260	274	290	306
	Exclusion of transportation-related fringe benefits	170	175	180	185	190
	Child and dependent care credit	181	183	185	186	188
	Deduction of health insurance paid by self-employed	145	153	162	173	183
	Exclusion of unemployment insurance benefits	135	140	144	147	151
	Personal property and other tax deduction	105	110	115	125	130
	Exemption for senior citizens	115	115	120	125	125
	Exclusion of employer contributions to life insurance plans	102	106	108	110	112
	Renters' credit	97	98	99	100	100

TABLE 1 (CONTINUED)

<b>Major Identifiable Tax Expenditures of \$5 Million or More</b> (Dollars in Millions)					
<b>Personal Income Tax (cont.)</b>	<b>State General Fund Revenue Loss</b>				
	2005-06 <sup>a</sup>	2006-07 <sup>e</sup>	2007-08 <sup>e</sup>	2008-09 <sup>e</sup>	2009-10 <sup>e</sup>
<b>Provision</b>	<b>\$63</b>	<b>\$63</b>	<b>\$63</b>	<b>\$64</b>	<b>\$64</b>
Exclusion of non-resident military pay	58	60	63	63	63
Exclusion of compensation for injuries or sickness	45	50	50	55	60
Exclusion of scholarship/fellowship income	37	39	42	45	48
Exclusion of capital gain on small business stock	42	43	44	46	45
Exclusion of employee child care benefits	35	35	35	40	40
Exclusion of meals and lodgings furnished by non-military employers	35	36	37	38	39
Exclusion of state lottery winnings	32	36	38	38	38
Exclusion of employer-provided educational assistance	21	24	27	30	32
Exclusion of income earned on Section 529 (Scholarshare) plans	25	26	28	29	31
Exclusion of foster care payment	24	25	26	28	30
Student loan interest deduction	24	25	25	25	26
Moving expense deduction	14	16	17	19	19
Exclusion of housing for clergy	10	10	10	10	10
Casualty losses deduction	10	10	10	10	10
Limited partnerships investment source rules	10	10	10	10	10
<b>Total</b>	<b>\$30,198</b>	<b>\$31,894</b>	<b>\$33,515</b>	<b>\$35,130</b>	<b>\$36,892</b>

<sup>a</sup>Actual

<sup>e</sup>Estimated

<sup>1</sup>This includes only personal income tax amounts; corporate tax amounts are separately reported.

<b>Major Identifiable Tax Expenditures of \$5 Million or More</b> (Dollars in Millions)						
<b>Corporation Tax</b>	<b>Provision</b>	<b>State General Fund Revenue Loss</b>				
		<b>2005-06<sup>a</sup></b>	<b>2006-07<sup>e</sup></b>	<b>2007-08<sup>e</sup></b>	<b>2008-09<sup>e</sup></b>	<b>2009-10<sup>e</sup></b>
	Subchapter S corporations <sup>1/</sup>	\$917	\$950	\$993	\$1,025	\$1,065
	Research and development credit <sup>1/</sup>	911	936	979	1,023	1,043
	Water's edge election	570	585	612	640	652
	Special treatment for economically depressed areas <sup>1/</sup>	360	402	418	454	488
	Accelerated depreciation of research and experimental costs <sup>1/</sup>	75	115	190	245	255
	Double-weighted sales factor	161	165	173	181	184
	Corporations exempt from minimum tax	114	116	118	120	123
	Charitable contributions deduction <sup>2/</sup>	96	99	102	105	108
	Low-income housing credit <sup>1/</sup>	45	45	50	50	55
	Employee stock ownership plans <sup>1/</sup>	39	43	46	47	51
	Natural Heritage Preservation Credit <sup>1/</sup>	6	10	15	13	13
	Credit union treatment	10	10	10	10	10
	Percentage depletion of mineral and other natural resources	4	4	4	4	4
	<b>Total</b>	<b>\$3,308</b>	<b>\$3,480</b>	<b>\$3,710</b>	<b>\$3,917</b>	<b>\$4,051</b>

<sup>a/</sup>Actual

<sup>e/</sup>Estimated

<sup>1/</sup>This item includes personal income tax amounts.

<sup>2/</sup>This includes only corporate tax amounts; personal income tax amounts are separately reported.

TABLE 3

**Major Identifiable Tax Expenditures of \$5 Million or More**  
(Dollars in Millions)

Sales and Use Taxes	2005-06 Revenue Loss			2006-07 Revenue Loss			2007-08 Revenue Loss			2008-09 Revenue Loss			2009-10 Revenue Loss		
	State Fund	General Fund	Local Fund	State Fund	General Fund	Local Fund	State Fund	General Fund	Local Fund	State Fund	General Fund	Local Fund	State Fund	General Fund	Local Fund
Food products	\$3,895	\$2,095	\$195	\$3,992	\$2,148	\$200	\$4,092	\$2,201	\$205	\$4,194	\$2,257	\$210	\$4,229	\$2,313	\$215
Gas, electricity, water, and steam	2,108	1,134	105	2,161	1,163	108	2,215	1,192	111	2,270	1,221	114	2,327	1,252	116
Prescription medicines	1,649	887	83	1,691	910	85	1,733	932	87	1,776	956	89	1,821	980	91
Candy, confectionery, snack foods, and bottled water	373	201	19	382	206	19	392	211	20	401	216	20	411	221	21
Exemption for farm equipment	106	-	5	109	-	5	112	-	6	114	-	6	117	-	6
Fuel sold to common carriers	97	52	5	99	53	5	102	55	5	104	56	5	107	58	5
Rental of linen supplies	68	37	3	70	38	4	72	39	4	73	39	4	75	40	4
Custom computer programs	49	26	3	50	27	3	52	28	3	53	29	3	54	29	3
Diesel fuel used in farming and processing	39	-	2	40	-	2	41	-	2	42	-	2	43	-	2
Water common carriers	31	16	2	31	17	2	32	17	2	33	18	2	34	18	2
Teleproduction and post production equipment	18	-	1	18	-	1	18	-	1	19	-	1	19	-	1
Food products sold through vending machines	8	5	0	9	5	0	9	5	0	9	5	1	9	5	1
Animal life, feed, seeds, plants, fertilizer, drugs, medicines	NA	NA	NA												
Meals furnished by institutions	NA	NA	NA												
Aircraft and component parts sales: common carriers, foreign, governments, nonresidents	NA	NA	NA												
Leases of motion picture and television films and tapes	NA	NA	NA												
Motion picture production services	NA	NA	NA												
Printed advertising	NA	NA	NA												
Subscription periodicals	NA	NA	NA												
<b>Total</b>	<b>\$8,441</b>	<b>\$4,453</b>	<b>\$422</b>	<b>\$8,651</b>	<b>\$4,565</b>	<b>\$433</b>	<b>\$8,867</b>	<b>\$4,679</b>	<b>\$443</b>	<b>\$9,089</b>	<b>\$4,796</b>	<b>\$454</b>	<b>\$9,246</b>	<b>\$4,916</b>	<b>\$466</b>

Major Identifiable Tax Expenditures of \$5 Million or More (Dollars in Millions)															
Other Taxes	2005-06 Revenue Loss			2006-07 Revenue Loss			2007-08 Revenue Loss			2008-09 Revenue Loss			2009-10 Revenue Loss		
	State General Fund	State Special Fund	Local												
<b>Fuel Tax</b>															
Aircraft jet fuel used by common carriers and military	-	\$76	-	-	\$78	-	-	\$81	-	-	\$83	-	-	\$86	-
Diesel and use fuel used by transit dist. and schools	-	13	-	-	13	-	-	14	-	-	14	-	-	15	-
<b>Total</b>															
<b>Cigarette Tax</b>															
Sales to government agencies	\$2	\$15	-	\$2	\$14	-	\$2	\$14	-	\$2	\$13	-	\$2	\$13	-

TABLE 5

<b>Major Identifiable Tax Expenditures of \$5 Million or More</b> (Dollars in Millions)						
<b>Property Tax</b>	<b>Provision</b>	<b>Local Revenue Loss</b>				
		<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>
	Computer programs	NA <sup>*</sup>	NA <sup>*</sup>	NA <sup>*</sup>	NA <sup>*</sup>	NA <sup>*</sup>
	Fixtures on the supplemental roll	\$88	\$29	\$16	\$17	\$18

<sup>\*</sup>In excess of \$100 million.

### Personal Income Tax

#### Home Mortgage Interest Deduction

**Description:**

Taxpayers may generally deduct a limited amount of interest paid or accrued within the taxable year for acquiring, constructing, substantially improving, or refinancing their principal and one other residence.

**Statutory Authority:**

Revenue and Taxation Code Section 17201 which conforms to Internal Revenue Code Section 163

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 4.1 million returns claimed a deduction for home mortgage interest expenses. This represented 6.8 million taxpayers.

**Comparable Federal Benefit:**

This provision conforms to federal law.

### Personal Income Tax

#### Exclusion of Employer Pension Contributions

**Description:**

Employer contributions to qualified retirement plans are generally excluded from employees' income, subject to annual limits.

**Statutory Authority:**

Revenue and Taxation Code Section 17501, which conforms to Internal Revenue Code Section 401

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

California generally conforms to federal law concerning employers' deductions for pension contributions.

**Personal Income Tax**

**Exclusion of Employer Contributions to Health Plans**

**Description:**

Contributions by employers to provide accident and health benefits are excluded from the income of employees.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 in conformity with Internal Revenue Code Section 106

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Capital Gain on Sale of a Principal Residence**

**Description:**

An individual may exclude up to \$250,000 of gain realized on the sale of a principal residence. For joint returns, the exclusion is \$500,000.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 and 17152 in conformity with Internal Revenue Code Section 121

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Personal Income Tax

### Charitable Contribution Deduction

**Description:**

A deduction is allowed for cash or certain non-cash contributions to qualifying nonprofit or governmental entities. For personal income taxpayers, the deduction is only available to those who itemize their deductions. The deduction amount is limited depending upon the type of contribution and recipient, but in no case may exceed 50 percent of adjusted gross income. For corporate taxpayers, the limit is 10 percent of taxable income. Contributions in excess of these amounts may be carried forward for up to five years.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201, 17275.5, 24357-24359.1 in conformity with Internal Revenue Code Section 170

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 4.0 million personal income tax returns claimed this deduction, representing 6.5 million taxpayers. Under the corporate tax, 134,000 returns claimed this deduction.

**Comparable Federal Benefit:**

This section conforms to federal law.

## Personal Income Tax

### Basis Step-Up on Inherited Property

**Description:**

The basis of property acquired by bequest, devise, or inheritance is the fair market value at the date of death. Therefore, appreciation that occurred prior to the death is not taxed.

**Statutory Authority:**

Revenue and Taxation Code Sections 18031, 18035.6, 18036.6 in conformity with Internal Revenue Code Section 1014

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Personal Income Tax

### Real Estate, Personal Property, and Other Taxes Deduction

**Description:**

Individual taxpayers may deduct certain taxes as an itemized deduction. This includes property taxes, personal property taxes including vehicle license fees, one-half of self-employment taxes, and other state, local, and foreign taxes relating to a trade or business or property held for the production of income.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201, 17220, 17222 which conforms to Internal Revenue Code Section 164

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 4.0 million tax returns (representing 6.7 million taxpayers) claimed the deduction for real estate taxes and 2.7 million tax returns (representing 4.5 million taxpayers) deducted personal property and other taxes.

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Personal Income Tax

### Exclusion of Benefits Provided Under Cafeteria Plans

**Description:**

The value of benefits received from an employer-sponsored cafeteria plan is not subject to tax. Cafeteria plans allow employees to choose between monetary compensation and qualified benefits, such as health insurance, life insurance, and dependent care benefits. If monetary compensation rather than benefits is selected, the amount is subject to tax.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 125

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Investment Income on Life Insurance and Annuity Contracts**

**Description:**

The proceeds of a life insurance policy of a deceased person are generally excluded from the income of the beneficiary. Amounts received from a "living benefits" contract are also excluded from income, as are certain survivor benefits paid as an annuity to the beneficiary of a public safety officer killed in the line of duty.

**Statutory Authority:**

Revenue and Taxation Code Sections 17131, 17132.5, 24302, and 24305 which conform to Internal Revenue Code Section 101

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

**Personal Income Tax**

**Exclusion of Social Security Benefits**

**Description:**

Social Security and federal railroad retirement benefits are not subject to tax.

**Statutory Authority:**

Revenue and Taxation Code Section 17087

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For 2004, 1.1 million tax returns claimed this exclusion, which represented 1.8 million taxpayers.

**Comparable Federal Benefit:**

Under federal law, these benefits are partially taxed.

### Personal Income Tax

#### Dependent Exemption in Excess of Personal Exemption Credit

**Description:**

A nonrefundable personal exemption credit is allowed for all taxpayers and their dependents. The exemption credit for dependents is over three times greater than the exemption allowed for the taxpayer or their spouse.

**Statutory Authority:**

Revenue and Taxation Code Sections 17054, 17054.1, 17056, and 17733

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

In 2004, 3.6 million tax returns (representing 6.1 million taxpayers) claimed this credit.

**Comparable Federal Benefit:**

Federal law allows a personal exemption deduction, rather than a credit. The deduction amount for dependents is the same as that for taxpayers. Federal law also allows a child tax credit of \$1,000 per child.

### Personal Income Tax

#### Employee Business and Miscellaneous Expenses Deduction

**Description:**

Certain unreimbursed employee expenses, expenses of producing income, and other qualifying expenses may be deducted as a miscellaneous itemized deduction. Amounts for meals and entertainment are limited to 50 percent of the expense. The deduction is limited; only the amount in excess of 2 percent of the taxpayer's federal adjusted gross income may be deducted.

**Statutory Authority:**

Revenue and Taxation Code Sections 17072, 17076, 17201 which generally conform to Internal Revenue Code Sections 62(a), 67, 68, 162, 274

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 1.5 million returns (representing 2.4 million taxpayers) claimed this deduction.

**Comparable Federal Benefit:**

This provision is in general conformity with federal law.

## Personal Income Tax

### Head-of-Household and Qualifying Widow(er) Filing Status

**Description:**

Individuals who provide a home for a qualifying relative are eligible for lower tax rates than are available for single persons or a married person filing separately.

A qualifying widow(er) may claim a larger personal exemption in addition to the lower tax rates provided to heads-of-households. A qualifying widow(er) is an individual whose spouse died within the two prior years and has not remarried, and who provides the main home for an eligible dependent.

**Statutory Authority:**

Revenue and Taxation Code Section 18521 which is in partial conformity with Internal Revenue Code Section 2

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

One million returns (representing 1.0 million taxpayers) used the head-of-household or qualifying widow filing status in 2004.

**Comparable Federal Benefit:**

This provision is in partial conformity with federal law.

## Personal Income Tax

### Depreciation Beyond Economic Depreciation

**Description:**

Depreciation deductions allow taxpayers to recover their investments in income-producing assets over specified periods. California Personal Income Tax Law conforms to certain federal accelerated depreciation provisions. California corporate depreciation deductions do not conform to federal law and corporations must use depreciation schedules that approximate actual economic depreciation.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201, 24349, and 24354.1 which partially conform to Internal Revenue Code Sections 167 and 168

**Sunset Date:**

None

**Legislative Intent:**

None

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision is in partial conformity with federal law.

**Personal Income Tax**

**Contributions to IRAs Deduction**

**Description:**

Taxpayers who receive compensation that is included in gross income and who are under 70-1/2 years of age may be allowed a deduction in computing adjusted gross income for contributions to their Individual Retirement Account (IRA). Earnings in IRAs are excluded from income until they are distributed to the taxpayer.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201, 17203, 17501, 17504-09, 17551, 17563.5 in conformity to Internal Revenue Code Section 219

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Contributions to Self-Employed Retirement Plans Deduction**

**Description:**

Self-employed persons are allowed a limited deduction when computing adjusted gross income for contributions to a self-employed retirement plan. Income generated by these contributions is also excluded from taxation until the assets are withdrawn.

**Statutory Authority:**

Revenue and Taxation Code Sections 17501, 17504, 17506, and 17507 which generally conform to Internal Revenue Code Sections 219, 401-404, 408, and 415

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Self-employed individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

**Personal Income Tax**

**Exclusion of Miscellaneous Fringe Benefits**

**Description:**

Certain fringe benefits are excluded from the income of the employees who receive them. This includes free special services such as free stand-by flights provided to airline employees, employee discounts for the purchase of company products, use of company equipment such as a company car, and "de minimis" fringe benefits such as the use of a work-site gym.

**Statutory Authority:**

Revenue and Taxation Code Section 17131, which partially conforms to Internal Revenue Code Section 132

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Unemployment Insurance Benefits**

**Description:**

Benefits received from the state's unemployment insurance program are excluded from income for tax purposes. For privately-provided unemployment compensation, benefits up to the amount of prior contributions are not taxable, but benefits in excess of this amount are taxable.

**Statutory Authority:**

Revenue and Taxation Code Section 17083

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

In 2004, 622,000 returns (representing 947,000 taxpayers) claimed this exclusion.

**Comparable Federal Benefit:**

None

## Personal Income Tax

### Medical and Dental Expenses Deduction

**Description:**

Taxpayers may take an itemized deduction for qualified medical and dental expenses incurred on behalf of the taxpayer, the taxpayer's spouse, and/or the taxpayer's dependents. Only unreimbursed expenditures that exceed 7.5 percent of federal adjusted gross income are deductible.

**Statutory Authority:**

Revenue and Taxation Code Section 17201 which conforms to Internal Revenue Code Section 213

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 671,000 returns (representing 1.0 million taxpayers) claimed this deduction.

**Comparable Federal Benefit:**

This conforms to federal law.

## Personal Income Tax

### Child and Dependent Care Credit

**Description:**

A refundable credit is allowed for a portion of qualifying child or dependent care expenses paid for the purpose of allowing the taxpayer to be gainfully employed. The credit is a percentage of a parallel federal credit. The percentage decreases as income increases and is eliminated for taxpayers with AGI greater than \$100,000.

**Statutory Authority:**

Revenue and Taxation Code Section 17052.6 which generally conforms to Internal Revenue Code Section 21

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

In 2004, 601,000 returns claimed this credit. This represented 894,000 taxpayers.

**Comparable Federal Benefit:**

This provision generally conforms to federal law, however federal law does not have an income limit.

## Personal Income Tax

### Teacher Retention Credit

**Description:**

A nonrefundable credit is allowed to credentialed teachers who are teaching kindergarten through 12<sup>th</sup> grade in a qualified educational institution in California.

**Statutory Authority:**

Revenue and Taxation Code Section 17052.2

**Sunset Date:**

Suspended for tax years 2002, 2004, 2005, and 2006, and repealed for tax years beginning January 1, 2007.

**Legislative Intent:**

This credit was intended to encourage teachers to stay in the teaching profession and to compensate them for unreimbursed expenses related to professional development and classroom instruction.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2003 tax year, 204,000 tax returns representing 341,000 taxpayers claimed this credit.

**Comparable Federal Benefit:**

None

## Personal Income Tax

### Exclusion of Transportation-Related Fringe Benefits

**Description:**

Employees are allowed to exclude qualified compensation for employer-provided transportation benefits from income. These benefits include up to a specified amount for parking, transit passes, and ridesharing programs. The exclusion is limited to the fair market value of the benefits received.

**Statutory Authority:**

Revenue and Taxation Code Sections 17090 and 17149 which generally conform to Internal Revenue Code Section 132

**Sunset Date:**

None

**Legislative Intent:**

This exclusion was intended to encourage ridesharing and transit use.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

## Personal Income Tax

### Deduction of Health Insurance Paid by Self-Employed

**Description:**

Self-employed individuals are allowed to deduct the cost of premiums paid for health insurance for themselves and their families. The deduction is limited to the taxpayer's net income earned from the trade or business for which the plan was established. This deduction can be taken regardless of whether the taxpayer itemizes their deductions.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201, 17203, 17273 which generally conform to Internal Revenue Code Section 162

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

In 2004, 401,000 returns (representing 669,000 taxpayers) claimed this deduction.

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

## Personal Income Tax

### Exemption for Senior Citizens

**Description:**

Individuals over the age of 65 are eligible for an additional personal exemption credit.

**Statutory Authority:**

Revenue and Taxation Code Sections 17054 and 17054.1

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 1.1 million returns representing 1.6 million taxpayers claimed this exemption.

**Comparable Federal Benefit:**

Federal law allows taxpayers over the age of 65 to claim an additional standard deduction amount.

**Personal Income Tax**

**Exclusion of Employer  
Contributions to Life Insurance  
Plans**

**Description:**

An employer's contribution to an employee's group term life insurance policy is exempted from the employee's gross income for the first \$50,000 of coverage.

**Statutory Authority:**

Revenue and Taxation Code Section 17081 which conforms to Internal Revenue Code Section 79

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Renters' Credit**

**Description:**

Low-income individuals who rent their principal residence are eligible for a credit of \$60 if they are single, or \$120 if married filing jointly or a head of household. In order to be eligible, the taxpayer's income cannot exceed specified levels.

**Statutory Authority:**

Revenue and Taxation Code Section 17053.5

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of  
Returns:**

In 2004, 1.4 million returns, representing 1.6 million taxpayers, claimed this credit.

**Comparable Federal Benefit:**

None

**Personal Income Tax**

**Exclusion of Nonresident Military Pay**

**Description:**

The military compensation of a person who is not domiciled or taxable in California, but attributable to a resident spouse because of community property laws is exempt from tax.

**Statutory Authority:**

Revenue and Taxation Code Sections 17140.5

**Sunset Date:**

None

**Legislative Intent:**

This provision was intended to ease administration and provide tax relief to military personnel.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This is a state-only issue.

**Personal Income Tax**

**Exclusion of Compensation for Injuries or Sickness**

**Description:**

Taxpayers may exclude from income the compensation received from workers' compensation, accident insurance, state disability insurance, and health insurance for injuries or illness. This also includes compensatory damages awarded in court settlements for injury or sickness, but not punitive damages. Also, employer reimbursement for expenses incurred for the care of an employee, an employee's spouse or dependents is excluded from tax.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 104

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of  
Scholarship/Fellowship Income**

**Description:**

Individuals may exclude from income any qualifying scholarships, fellowships, and tuition grants or reductions they receive that are used for qualified educational expenses.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 117

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Employee Child Care  
Benefits**

**Description:**

Employees may exclude the amount of child and dependent care benefits received through an employer-sponsored payroll deduction program. The exclusion is the lesser of \$5,000 per year, the amount of the taxpayer's earned income, or the amount of the taxpayer's spouse's earned income.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 129

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Personal Income Tax

### Exclusion of Capital Gain on Small Business Stock

**Description:**

Fifty percent of the gain from the sale of qualified small business stock that is held for at least five years is excluded from income. For married couples, the exclusion is limited to \$10 million or ten times the stock's basis. The limit for single persons is less.

**Statutory Authority:**

Revenue and Taxation Code Section 18152.5 which partially conforms to Internal Revenue Code Section 1202

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law except for California purposes 80 percent of the corporation's payroll must be attributable to California and 80 percent of the corporation's assets have to be used in the active conduct of a trade or business in California for substantially all of the taxpayer's holding period.

## Personal Income Tax

### Exclusion of Meals and Lodging Furnished by Non-Military Employers

**Description:**

The value of meals and lodging furnished by non-military employers to an employee, spouse, or dependent is excluded from the income of the employee. The meals and lodging must be provided at the employer's place of business, for the convenience of the employer, and a precondition for employment.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 119

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Employer-Provided Educational Assistance**

**Description:**

Individuals may exclude from income up to \$5,250 of qualified educational assistance contributions made by their employer.

**Statutory Authority:**

Revenue and Taxation Code Section 17151 which partially conforms to Internal Revenue Code Section 127

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

**Personal Income Tax**

**Exclusion of State Lottery Winnings**

**Description:**

Winnings from the California State Lottery are exempt from tax.

**Statutory Authority:**

Government Code Section 8880.68

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

## Personal Income Tax

### Student Loan Interest Deduction

**Description:**

Taxpayers may deduct interest paid on qualified education loans up to a maximum amount. This deduction is phased out for taxpayers above a specified income level.

**Statutory Authority:**

Revenue and Taxation Code Section 17204 which conforms to Internal Revenue Code Section 221

**Sunset Date:**

None

**Legislative Intent:**

The intent of this provision was to make the expenses of higher education more affordable.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

In 2004, 556,000 tax returns used this deduction. This represented 813,000 taxpayers.

**Comparable Federal Benefit:**

None

## Personal Income Tax

### Exclusion of Foster Care Payments

**Description:**

Payments received from state and local governments, as well as tax-exempt foster care placement agencies, as reimbursements for the costs of caring for a foster child are excluded from income. The foster child must live in the taxpayer's home for the exclusion to apply.

**Statutory Authority:**

Revenue and Taxation Code Section 17131 which conforms to Internal Revenue Code Section 131

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Moving Expense Deduction**

**Description:**

An above-the-line deduction is allowed for certain unreimbursed moving expenses that are required to start a new job. The deduction is limited to the cost of transportation of household goods and personal effects, and travel (including lodging, but not meals) to the new residence.

**Statutory Authority:**

Revenue and Taxation Code Sections 17072 and 17076, which conform to Internal Revenue Code Section 217

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

For 2004, 189,000 tax returns (representing 285,000 taxpayers) claimed this deduction.

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Personal Income Tax**

**Exclusion of Income Earned on Section 529 (Scholarshare) Plans**

**Description:**

Individuals may exclude earnings of Section 529 educational savings accounts (such as California's Scholarshare program) from income, provided that, upon withdrawal, the money from the accounts is used for qualified educational expenses.

**Statutory Authority:**

Revenue and Taxation Code Section 17140 which conforms to Internal Revenue Code Section 529

**Sunset Date:**

None

**Legislative Intent:**

This provision was intended to encourage taxpayers to invest for future higher education expenses in order to make the attainment of higher education possible for the greatest number of citizens of California.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law.

## Personal Income Tax

### Exclusion of Housing for Clergy

**Description:**

The rental value of a minister's dwelling is exempt from tax. Also, state-employed members of the clergy may allocate up to 50 percent of their gross salary to either the rental value of a home furnished to them or to the rental allowance paid to them to rent a home.

**Statutory Authority:**

Revenue and Taxation Code Sections 17131 and 17131.6, which partially conform to Internal Revenue Code Section 107

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision partially conforms to federal law.

## Personal Income Tax

### Casualty Loss Deduction

**Description:**

Taxpayers may deduct from gross income qualified casualty losses for which they were not compensated by insurance or other means. Casualty losses are losses caused by sudden, unexpected, or unusual events, such as floods, fires, storms, earthquakes, vandalism, theft, etc. Casualty losses are limited to losses that are greater than \$100 per loss and where the sum of all casualty losses during a year is greater than 10 percent of federal adjusted gross income.

**Statutory Authority:**

Revenue and Taxation Code Sections 17131, 17207, and 24347.5 which generally conform to Internal Revenue Code Section 165

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals, incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision generally conforms to federal law except that it is limited to losses sustained in California.

## Personal Income Tax

### Limited Partnerships Investment Source Rules

**Description:**

The dividends, interest, or gains and losses from qualified investment securities of members of limited partnerships are exempted from taxation if they reside outside California, and their only contact with this state is through a security dealer, broker, or an investment advisor located in this state.

**Statutory Authority:**

Revenue and Taxation Code Section 17955

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

This is a state-only issue.

## Corporation Tax

### Subchapter S Corporations

**Description:**

Corporations that meet specified criteria are allowed to elect Subchapter S corporation status for tax purposes. S corporations pay tax on corporate income at a reduced rate of 1.5 percent, except for financial institutions, which are subject to a 3.5 percent rate. S corporations are not subject to the Alternative Minimum Tax but are subject to the applicable corporate minimum tax. Individual shareholders of an S corporation pay personal income taxes on their pro rata share of corporate income.

**Statutory Authority:**

Revenue and Taxation Code Sections 17087.5, 18006, and 23800-23813, which partially conform to Internal Revenue Code Sections 1361-1379

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of Returns:**

For the 2005 tax year, there were 315,136 S corporation returns, and 346,177 personal income tax returns reporting some S corporation income/loss.

**Comparable Federal Benefit:**

This provision generally conforms to federal law, however no entity-level tax is imposed at the federal level.

## Corporation Tax

### Research and Development Credit

**Description:**

Businesses are allowed a credit for increased research expenditures over a four-year base period.

**Statutory Authority:**

Revenue and Taxation Code Sections 17052.12 and 23609 in partial conformity with Internal Revenue Code Section 41

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

For 2004, 3,300 personal income tax returns (representing 5,700 taxpayers) and 1,800 corporate tax returns claimed this credit.

**Comparable Federal Benefit:**

This provision partially conforms to federal law.

## Corporation Tax

### Water's Edge Election

**Description:**

Unitary multinational corporations are allowed the option of computing the income attributable to California on the basis of a water's-edge (domestic) combined report, as opposed to a worldwide combined report. Under the water's edge provision, a business may elect to compute its California tax by reference to only the income and factors of a limited number of entities. In general, these entities include United States incorporated entities, the United State activities of foreign incorporated entities, and the activities of various foreign entities that are included in the federal consolidated return. The election is generally for a seven-year period.

**Statutory Authority:**

Revenue and Taxation Code Sections 25110-25113

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Corporations

**Number of Taxpayers/Number of Returns:**

For 2004, 6,000 returns elected the water's edge method.

**Comparable Federal Benefit:**

Federal law uses a different method of determining income subject to tax, but it relies on the same information as the water's edge method.

## Corporation Tax

### Accelerated Depreciation of Research and Experimental Costs

**Description:**

Research and experimental expenditures may be deducted currently, or may be amortized over a 60-month period at the election of the taxpayer.

**Statutory Authority:**

Revenue and Taxation Code Sections 17201 and 24365, which conform to Internal Revenue Code Sections 59 and 174

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Corporation Tax

### Special Treatment for Economically Depressed Areas

#### Description:

Several tax incentives are available for certain types of expenditures or income earned in economically depressed areas of the state. These include areas designated as Enterprise Zones (EZs), Local Agency Military Base Recovery Areas (LAMBRAs), Targeted Tax Areas (TTAs), and Manufacturing Enhancement Areas (MEAs).

- (1) Employers in these areas may be allowed a credit for a portion of the wages paid to qualified individuals.
- (2) Employers may be eligible for a credit for the amount of sales and use taxes paid on certain purchases of machinery or part.
- (3) Employees in these designated areas may be eligible for an income tax credit of five percent of their qualified wages.
- (4) Taxpayers may exclude the net interest from certain investments or loans to businesses in economically distressed areas.
- (5) Businesses in designated areas are allowed to expense part of the costs of business equipment beyond normal expensing limits.

#### Statutory Authority:

Chapter 12.8 of the Government Code, and Revenue and Taxation Code Sections 17053.33, 17053.34, 17053.45, 17053.46, 17053.47, 17053.7, 17053.74, 17053.75, 17268, 17276.2, 23612.2, 23622.7, 23622.8, 23633, 23634, 23645, 23646

#### Sunset Date:

None

#### Legislative Intent:

These provisions were intended to help attract business and industry to the state, and more specifically to selected areas meeting various criteria, to help retain and expand existing state business and industry, and to create increased job opportunities for all Californians.

#### Beneficiaries:

Individuals and incorporated and unincorporated businesses

#### Number of Taxpayers/Number of Returns:

In 2004, 5,500 personal income tax returns (representing 9,600 taxpayers) and 3,600 corporate returns claimed these tax incentives.

#### Comparable Federal Benefit:

These provisions do not conform to federal law, however federal law does provide similar tax incentives for designated empowerment zones and renewal communities.

### Corporation Tax

#### Double-Weighted Sales Factor

**Description:**

Corporations with income derived from sources both within and outside California must apportion income using a formula that takes into account payroll, property, and sales factors. Prior to January 1, 1993, California applied a three-factor formula in which the payroll, property, and sales factors were equally weighted. After that date, California adopted a formula in which the sales factor is double-weighted. Corporations engaged in qualified agricultural, extractive, and financial business activities are exempted from the double-weighted sales formula, and must continue using the equally weighted three-factor formula to apportion their worldwide income.

**Statutory Authority:**

Revenue and Taxation Code Section 25128

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Corporations

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 56,000 returns used the double-weighted sales factor formula.

**Comparable Federal Benefit:**

None

### Corporation Tax

#### Corporations Exempt from the Minimum Tax

**Description:**

A minimum tax of \$800 is generally imposed on corporations subject to the corporation franchise tax. However, corporations in their first year of business are generally not subject to the minimum tax.

**Statutory Authority:**

Revenue and Taxation Code Section 23153

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Corporations

**Number of Taxpayers/Number of Returns:**

In 2004, 138,000 returns claimed this exemption.

**Comparable Federal Benefit:**

None

## Corporation Tax

### Credit Union Treatment

**Description:**

Credit unions are exempt from state income and franchise taxes. Since credit unions are nonprofit, membership organizations, only their "nonmember" income (such as investment income on excess deposits or miscellaneous sources of income, such as ATM fees charged to nonmembers) would be taxed in the absence of this exemption.

**Statutory Authority:**

Revenue and Taxation Code Section 23153

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Non-profit cooperative associations

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

## Corporation Tax

### Low-Income Housing Credit

**Description:**

A tax credit is allowed for a portion of the costs of investing in qualified low-income rental housing. The aggregate amount of the credit is capped, and specific credits are allocated to applicants by the California Tax Credit Allocation Committee. Credits are allocated to developers who, in turn, sell them to investors in exchange for project funding. All projects receiving the California credit must also receive the parallel federal credit.

**Statutory Authority:**

Revenue and Taxation Code Sections 17058 and 23610.5 in conformity with Internal Revenue Code Section 42

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals, unincorporated and incorporated businesses

**Number of Taxpayers/Number of Returns:**

For the 2004 tax year, 30 returns claimed this credit.

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Corporation Tax

### Employee Stock Ownership Plans (ESOP)

**Description:**

Employers that provide employee stock ownership plans are allowed a deduction for dividends paid to an ESOP, when those dividends are paid by the ESOP to participants or are used to retire ESOP debt. Also, capital gains on the sale of stock to an ESOP are deferred if the proceeds are used to acquire a similar type of security.

**Statutory Authority:**

Revenue and Taxation Code Sections 18042 and 24601-24612, which generally conform to Internal Revenue Code Sections 401-424 and 1042

**Sunset Date:**

None

**Legislative Intent:**

This provision was intended to broaden employee ownership of California businesses, as well as prevent undue recordkeeping burdens and costs of compliance by being out of conformity with federal law.

**Beneficiaries:**

Incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

## Corporation Tax

### Natural Heritage Preservation Tax Credit

**Description:**

Taxpayers may claim a nonrefundable credit for 55 percent of the fair market value of real property donated for conservation purposes to the California Resources Agency, a local government, or a designated exempt nonprofit land and water conservation organization.

**Statutory Authority:**

Revenue and Taxation Code Section 17053.30, Public Resources Code Sections 37001-37022

**Sunset Date:**

June 30, 2008

**Legislative Intent:**

This provision was intended to help protect wildlife habitat, open space, and agricultural lands.

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of Returns:**

For 2004, less than 10 returns claimed this credit.

**Comparable Federal Benefit:**

None

## Corporation Tax

### Percentage Depletion of Mineral and Other Resources

**Description:**

Taxpayers may deduct a fixed percentage of gross income for resource depletion, which is generally more than the deduction that would be allowed under the normal cost-depletion method. The percentage depends upon the type of resource, and the depletion allowance cannot be more than 50 percent of the taxpayer's related net income prior to the depletion deduction, or more than 100 percent for oil and gas properties.

**Statutory Authority:**

Revenue and Taxation Code Sections 17681 and 24831

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Incorporated and unincorporated businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Sales and Use Taxes**

**Food**

**Description:**

Sales of food for human consumption are not generally subject to the sales and use taxes. However, this exemption does not generally include hot prepared food, food sold and consumed at or on the seller's facility, or food sold for consumption where there is an admission charge.

**Statutory Authority:**

Revenue and Taxation Code Section 6359

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Gas, Electricity, Water**

**Description:**

Gas, electricity, and water delivered through mains, lines, or pipes are exempt from tax. Water sold in bulk quantities of 50 gallons or more and liquefied petroleum gas delivered for use in a residence is also exempt.

**Statutory Authority:**

Revenue and Taxation Code Section 6353

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Prescription Medicine**

**Description:**

Medicine that is prescribed for a human being and furnished by a registered pharmacist is exempt from tax. This exemption also includes such things as orthotic and prosthetic devices and parts.

**Statutory Authority:**

Revenue and Taxation Code Sections 6369 and 6369.1

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Candy, Confectionery, Snack Foods, and Bottled Water**

**Description:**

Candy, gum, confectionery, snack foods, and bottled water are not subject to the sales and use taxes.

**Statutory Authority:**

Revenue and Taxation Code Section 6359

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Farm Equipment and Machinery**

**Description:**

Sales of farm equipment, machinery, and their parts are exempt from the 5 percent state sales and use tax when sold to qualified persons engaged in the business of producing and harvesting agricultural products.

**Statutory Authority:**

Revenue and Taxation Code 6356.5

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

In 2005-06, 12,785 returns claimed this exemption.

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Fuel Sold to Common Carriers**

**Description:**

Sales of fuel and petroleum products to air common carriers for international flights are exempt from tax.

**Statutory Authority:**

Revenue and Taxation Code Section 6357.5

**Sunset Date:**

None

**Legislative Intent:**

This provision was intended to allow domestic fuel producers to compete equally with foreign producers, who are exempt under federal law from state sales taxes on airline fuel used in international travel.

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Rental of Linen Supplies**

**Description:**

A person leasing linen supplies and similar articles who furnishes the recurring service of laundering or cleaning such linen supplies is the consumer of the property provided and tax applies to the purchase of the items.

**Statutory Authority:**

Revenue and Taxation Code Section 6006 and 6010

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Custom Computer Programs**

**Description:**

The transfer of custom computer programs, other than a basic operational program, and separate charges for custom modifications to existing prewritten programs are excluded from the definition of "sale."

**Statutory Authority:**

Revenue and Taxation Code 6010.9

**Sunset Date:**

None

**Legislative Intent:**

This provision was intended to provide an incentive for the development and utilization of computer software.

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Diesel Fuel Used in Farming and Processing**

**Description:**

Sales of diesel fuel are exempt from the 5 percent state sales and use tax when that fuel is consumed during the activities of a farming or food processing business. Farming business includes transporting farm products to the marketplace.

**Statutory Authority:**

Revenue and Taxation Code 6357.1

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

In 2005-06, 1,451 returns claimed this exemption.

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Water Common Carriers**

**Description:**

The sale of fuel and petroleum products is exempt when sold to a water common carrier for immediate shipment outside this state.

**Statutory Authority:**

Revenue and Taxation Code Section 6385

**Sunset Date:**

January 1, 2014

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

### Sales and Use Taxes

#### Teleproduction and Post Production Equipment

**Description:**

Sales of teleproduction and post production equipment to businesses primarily engaged in teleproduction and post production activities is exempt from the 5 percent state sales and use tax when that property is used 50 percent or more in those activities.

**Statutory Authority:**

Revenue and Taxation Code Section 6378

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of  
Returns:**

In 2005-06, 2,236 returns claimed this exemption.

**Comparable Federal Benefit:**

None

### Sales and Use Taxes

#### Treatment of Vending Machine Sales

**Description:**

Sales through vending machines are subject to tax on 33 percent of the sales price. Also, vending machine operators are considered the consumer of food products sold below a specified price through a vending machine.

**Statutory Authority:**

Revenue and Taxation Code Sections 6359.2 and 6359.4

**Sunset Date:**

None

**Legislative Intent:**

This provision was designed to simplify tax auditing procedures and provide uniformity in the taxation of vending machine sales. The percentage was set at 33 percent because that was deemed the average statewide percentage of vending machine sales that were subject to tax.

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Animal Life, Feed, Seeds, Plants,  
Fertilizer, Drugs, and Medicines**

**Description:**

Sales of animals which are generally used for human food, as well as the feed and drugs used for those animals is exempt from tax. Also, seeds and plants that are normally used for human food and fertilizer for those plants are exempt from tax.

**Statutory Authority:**

Revenue and Taxation Code Section 6358

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Meals Furnished by Institutions**

**Description:**

Meals furnished by institutions such as health facilities, residential care facilities for the elderly, drug treatment facilities, community care facilities, and alcohol recovery facilities are not subject to tax.

**Statutory Authority:**

Revenue and Taxation Code Section 6363.6

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of  
Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Aircraft and Component Parts Sales**

**Description:**

The sale of aircraft and component parts to common carriers, foreign governments, or nonresidents is not subject to tax.

**Statutory Authority:**

Revenue and Taxation Code Section 6366

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals, businesses, foreign governments

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Leases of Motion Picture and Television Films and Tapes**

**Description:**

Leases of motion pictures, animated motion pictures, and television films and tapes are not considered sales. The lessor is considered the consumer of such tangible personal property it leases.

**Statutory Authority:**

Revenue and Taxation Code Section 6006 and 6010

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Periodicals**

**Description:**

Sales of periodicals that appear at stated intervals of at least 4 times per year but not more than 60 times per year, and their ingredient and component parts are exempt from the sales and use taxes when the periodical is sold by subscription and delivered by mail or common carrier.

**Statutory Authority:**

Revenue and Taxation Code Section 6362.7

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Individuals and businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Sales and Use Taxes**

**Printed Advertising**

**Description:**

Sales of printed material which is substantially advertisements for good and services are exempt from tax if the material is (1) printed to the special order of the purchaser, (2) mailed or delivered by the seller, the seller's agent, or a mailing house, and (3) delivered to another person at no cost to that person.

**Statutory Authority:**

Revenue and Taxation Code 6379.5

**Sunset Date:**

None

**Legislative Intent:**

This provision appears to have been intended to assist the California printing industry increase its share of the direct mail and catalog market.

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

## **Cigarette and Tobacco Products Tax**

### **Sales to Government Agencies**

**Description:**

Sales of cigarettes and tobacco products by or through the United States military exchanges, commissaries, ship's stores, or the United States Veterans' Administration are not subject to the cigarette tax. Deliveries of cigarettes or tobacco products to a veterans' home of this state or a hospital or domiciliary facility of the United States Veterans' Administration for the use of the veterans are also not subject to tax.

**Statutory Authority:**

Revenue and Taxation Code Sections 30102 and 30105.5

**Sunset Date:**

The exemption for sales by or through military installations will sunset on the first calendar day beginning more than 60 days after federal law is changed to allow state taxation of military sales.

**Legislative Intent:**

This exemption was intended to provide a tax incentive for the United States Armed Forces and the United States Veterans' Administration to purchase cigarettes or tobacco products in this state, as opposed to purchasing cigarettes outside this state for purposes of avoiding the tax. The exemption was also intended to provide tax relief to various members of the United States Armed Forces by enabling them to acquire their cigarettes and tobacco products at reduced costs.

**Beneficiaries:**

Individuals

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This conforms to federal law.

**Fuel Taxes**

**Aircraft Jet Fuel Used by Common Carriers**

**Description:**

Air common carriers engaged in the business of transporting persons or property for compensation under certification of public necessity by the state, national, or any foreign government, persons engaged in the business of constructing or reconstructing aircraft, and the United States armed forces are exempt from the tax on aircraft jet fuel.

**Statutory Authority:**

Revenue and Taxation Code Section 7389

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses and U.S. government

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

This provision conforms to federal law.

**Fuel Taxes**

**Fuel Used by Transit Districts and Schools**

**Description:**

Diesel fuel purchased by certain public transit agencies, school districts, and common carriers is taxed at a reduced rate of 1-cent-per-gallon.

**Statutory Authority:**

Revenue and Taxation Code Sections 8655, 60039, and 60502.2

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Government agencies and businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

Federal law exempts these sales.

**Property Tax**

**Computer Programs**

**Description:**

Computer programs other than basic operational programs which are necessary for the fundamental functioning of the computer are exempt from tax. The storage media for the programs are, however, taxable.

**Statutory Authority:**

Revenue and Taxation Code 995

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None

**Property Tax**

**Fixtures Excluded From the Supplemental Roll**

**Description:**

Fixtures that are valued as a separate appraisal unit from the structure on the property are exempt from supplemental property tax assessment. Fixtures are personal property such as equipment that are affixed to and incorporated into real property.

**Statutory Authority:**

Revenue and Taxation Code Section 75.5

**Sunset Date:**

None

**Legislative Intent:**

Not specified

**Beneficiaries:**

Businesses

**Number of Taxpayers/Number of Returns:**

Not available

**Comparable Federal Benefit:**

None



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