Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Rod Pacheco	Analyst:	Kristina E. North	Bill Number:	AB 350
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 16, 2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Medical Expenses Credit/Taxpayers 65 Years or Older/FTB Report to Legislature

SUMMARY

This bill would authorize a credit for senior citizens of up to $400 for medical expenses.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide financial relief to senior citizens for the cost medical expenses.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately. This bill would apply to taxable years beginning on or after January 1, 2001, and before January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws specifically allow unreimbursed medical care expenses, including costs for prescription drugs or insulin, to be deducted for income tax purposes. The expenses may be deducted only to the extent that they exceed 7.5% of the taxpayer's adjusted gross income (AGI). Medical care expenses for the taxpayer or the taxpayer's dependent(s) include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease or for treatments affecting any part or function of the body. The expenses must primarily alleviate or prevent a physical or mental defect or illness. A taxpayer may also include amounts paid for the following items: transportation and car expenses primarily for and essential to medical care; meals and lodging, not provided in a hospital or similar institution, primarily for and essential to medical care; qualified long-term care services; and insurance including supplementary medical insurance for the aged or a qualified long-term care insurance contract.

Board Position:			Department Director	Date
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Prescribed drugs and insulin are considered medical care expenses for the purposes of this deduction. "Prescribed drug" is defined as a drug or biological that requires a prescription by a physician for its use by an individual. A biological could include bacterial vaccines, blood products, prions, cellular immunology, cytokines and allied mediators, diagnostics, general bacteriology, general virology, endogenous and adventitious viruses, hormones, immunochemistry, monoclonal antibodies, parasite, protein chemistry, toxins, toxoids, and viral vaccines.

Current federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

THIS BILL

Under the Personal Income Tax Law, **this bill** would allow a credit for qualified taxpayers equal to 20% of qualified medical expenses. These qualified medical expenses cannot exceed $2,000, thus limiting the credit to no more than $400.

This bill provides the following definitions:

- "Qualified medical expenses" means expenses for medical care as described under the Internal Revenue Code (“Federal/State Law” above), without regard to any AGI restriction.

- A "qualified taxpayer" must be 1) an individual who is 65 years or older by December 31 of the taxable year, or in the case of a married couple filing a joint return two individuals who *both* are, 65 years or older by December 31 of the taxable year **AND** 2) **either** an individual with an AGI of $37,500 or less, or married filing a joint return or a head of household with an AGI of $75,000 or less.

This bill requires the Franchise Tax Board to report annually, to the extent data are available, on how this credit was used.

This bill specifies that no deduction or credit would be allowed for the same expenses for which this credit was allowed.

This bill allows any unused credit to be carried over for up to eight years after the credit is earned.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- This bill characterizes two individuals (married filing a joint return) as a single taxpayer entitled to only one credit of up to $400. Additionally, this bill denies a credit to a married couple filing a joint return if only one spouse is 65 years or older. A married couple filing a joint return at the federal level must also file a joint return for California purposes. Thus, to receive the same benefits provided by this credit to single taxpayers, the couple must each file a married filing a separate return at both the federal and state levels to each receive a credit of up to $400, or to claim the credit in the event that only one spouse is 65 or older.

- "Individual" is not a filing status. Normally, language imposing AGI limitations based on filing status covers the filing statuses of single, married filing separate, and surviving spouse.

- If the author intends this credit be claimed *only* for care or drugs purchased for the use of the individual who is 65 or older, the author may wish to consider amending the bill accordingly.

LEGISLATIVE HISTORY

SB 155 (Oller, 2001/2002) would allow a 100% credit to individuals over 55 years of age for the costs of prescription drugs that are not reimbursed or paid for by insurance. This bill currently is in the Senate Revenue and Taxation Committee.

AB 2533 (Robert Pacheco, 1999/2000) would have allowed a credit equal to 25% of costs paid by a taxpayer for prescription drugs. The credit would have been limited to $300 for an individual and $600 for a married couple filing jointly. This bill failed to pass the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Michigan currently has a refundable prescription drug tax credit for individuals 65 years of age or older whose household income does not exceed 150% of the federal poverty level. The individual may not be a resident in a health care or mental care facility licensed or operated by the state. The prescription drug must be purchased directly by the individual and the cost cannot be covered by a third party reimbursement plan. The credit is not reported on the individual's return as an offset against tax liability, but is claimed on a separate form prescribed by the revenue department. However, **Michigan** does not currently have a medical expenses tax credit.

A review of **Illinois, Massachusetts, Minnesota**, and **New York** laws found no comparable tax credits or deductions. However, both **Illinois** and **New York** are pursuing legislation in the area of a prescription drug tax credit.

These states were reviewed because of similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses under the PIT Law.

Estimated Revenue Impact of AB 350 Enactment Assumed after June 30, 2001 As Introduced February 16, 2001 [$ In Millions]		
2001/2002	2002/2003	2003/2004
-$95	-$90	-$90

Estimates assume that only one credit could be claimed on a joint return where both individuals are age 65 or older and that no credit could be claimed where only one individual is 65 years or older. (If the bill was amended to allow each individual to claim a credit where both individuals are 65 or older or one credit where only one individual filing a joint return is 65 years or older, the revenue loss would increase significantly, by roughly two-thirds for each fiscal year.)

Tax Revenue Discussion

The amount of medical expenses up to $2,000 incurred by qualified taxpayers and the amount of credits that could be applied to reduce tax liabilities would determine the revenue impact of this bill.

Based on national household spending data for 1997, the average annual out-of-pocket expenditure for healthcare expenses by seniors is projected at $3,680 in 2001. Only healthcare expenses up to $2,000 annually would qualify for the proposed tax credit. Multiplying qualified healthcare expenditures of $2,000 by the proposed credit percentage of 20% derives an average credit equal to the proposed maximum of $400.

A simulation was performed using personal income tax sample data. The senior exemption credit was increased by the proposed maximum credit of $400 for taxpayers with AGI of $37,500/$75,000 or less (single and head of household/joint). Assuming each qualified taxpayer in the sample generated the maximum credit, the simulation models the maximum revenue loss to the extent credits generated could be applied to reduce tax liabilities. The portion of the revenue loss to attributable to qualified seniors filing joint returns was reduced to reflect a single credit for joint returns with two seniors and no credit for returns with one senior. Additional reduction adjustments were made to the model result to allow for the following: (1) taxpayers with healthcare expenses insufficient to generate the maximum credit, (2) for the portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold), and (3) to reflect the rate at which qualified taxpayers would, in fact, report the credit on their tax returns.

POLICY CONCERNS

This bill treats a married couple filing a joint return differently from other taxpayers by allowing only one credit for two individuals that are married and would independently qualify for this credit if they were unmarried. Thus, two individuals filing separately would receive up to a $400 credit each, but a married couple filing a joint return would receive only one credit up to $400.

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