Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Strickland | Analyst: Kristina E. North | Bill Number: AB 513

Related Bills: See Legislative History | Telephone: 845-6978 | Amended Date: April 25, 2001

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Prescription Drug Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______________.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ______________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ______________.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ______________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY

This bill would create a 100% credit for seniors 65 years or older for the costs of prescription drugs.

SUMMARY OF AMENDMENTS

The April 25, 2001, amendments specified that a licensed health care professional acting within the scope of his or her license may prescribe a prescription drug and makes a nonsubstantive technical change.

The March 26, 2001, amendments defined "prescription drugs" and "health plan."

This is the department's first analysis on this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to defray the costs of prescription drugs for senior citizens.

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.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Alan Hunter for GHG	05/14/01
____ SA	____ O	____ NAR		
____ N	____ OUA	__X__ PENDING		

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author with resolving the concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws specifically allow unreimbursed medical care expenses, including costs for prescription drugs or insulin, as an itemized deduction 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). Federal law defines "prescribed drug" as a drug or biological that requires a prescription of a physician for its use by an individual.

Current federal and state laws contain various tax credits designed to provide tax relief for taxpayers that 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.

Neither federal nor state law has a credit comparable to the prescription drug tax credit proposed by this bill.

THIS BILL

This bill would create a 100% credit, up to $650, for a taxpayer 65 years of age or older for costs of prescription drugs that were not reimbursable or payable by a health plan.

This bill would define:

- "Prescription drugs" as a drug or biological prescribed by a ***licensed health care professional*** for use by an individual;

- "Health plan" as an individual or group plan providing or paying for medical care. "Health plan" would include various health programs and policies or any combination thereof.

Any excess credit could be carried over indefinitely until used.

IMPLEMENTATION CONSIDERATIONS

- A definition is necessary for the phrase "not reimbursable or payable." It would be difficult to determine whether a particular drug expense is "reimbursable" or "payable."

- This bill would allow a taxpayer to claim this credit for prescription drugs even if the drugs are purchased for a member of the taxpayer's family or for transfer or resale to another person. If the author intends that this credit should be claimed only on drugs purchased for the use of the individual who is at least 65, the author may wish to consider amending the bill accordingly.

TECHNICAL CONSIDERATIONS

The bill erroneously identifies applicable federal law by reference to the law as reflected in the publication of a commercial publisher, i.e., United States Code Annotated, rather than the official federal law, the United States Code.

The bill defines "health plan" to include one or any combination of 13 precisely defined categories of medical or health programs. It appears the author intends to identify all health plans. However, since the list appears exhaustive rather than illustrative, some health plans may be excluded. The author may wish to make the listing illustrative, i.e., "includes, but is not limited to, the following."

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 is in the Senate Revenue and Taxation Committee.

AB 1166 (Campbell, 2001/2002) would allow a 25% credit to individuals 65 years of age or older for prescription drugs costs. The credit would be limited to $300 for an individual or $600 in the case of a married couple filing a joint return. This bill is in the Assembly Revenue and Taxation Committee.

AB 2533 (Pacheco, 1999/2000) would have allowed a 25% credit for a taxpayer's prescription drug costs. 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 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 income tax return, but is claimed on a separate form prescribed by the revenue department.

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 this area.

These states were reviewed because of the 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.

Estimated Revenue Impact of AB 513 As Amended March 26, 2001 Assumed enactment after June 30, 2001 [$ In Millions]		
2001/2002	2002/2003	2003/2004
-$540	-$540	-$630

This analysis assumes the qualifying taxpayer must also be the user of the prescribed drugs, that is, not acquired for transfer or resale to someone else

Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of unreimbursed costs incurred for prescription drugs by qualified taxpayers and the amount of credits that could be applied to reduce tax liabilities.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs by individuals age 65 and older was projected at $675 for 2001. A simulation was performed using personal income tax sample data. As the proposed credit is for 100% of unreimbursed costs up to $650, the senior exemption credit was increased by $650 as a proxy for the new credit. Assuming each qualified taxpayer in the sample generated the average credit, the simulation models the maximum revenue loss to the extent credits generated could be applied to reduce tax liabilities. Model results were reduced for the rate at which qualified taxpayers would actually report the credit on their tax returns.

POLICY CONCERNS

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are used within eight years of being earned.

Conflicting tax policies come into play when a credit is provided for an item that is already deductible as an itemized deduction. Allowing both the credit and the deduction would provide a double benefit for that item. On the other hand, prohibiting the deduction creates a difference between state and federal taxable income, which is contrary to the state's general conformity policy.

LEGISLATIVE STAFF CONTACT

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