Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Strickland	Analyst:	Deborah Barrett	Bill Number:	AB 2698
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	February 24, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Hearing Aids Credit

SUMMARY

This bill would provide an income tax credit for individual taxpayers for the purchase of a hearing aid.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to assist taxpayers with the costs related to obtaining a hearing aid.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and by the specific terms of the bill, would be operative for taxable years beginning on or after January 1, 2006.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing federal and state laws provide various tax credits designed to provide tax relief to 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.

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business. Existing federal law does not have a credit comparable to that proposed in this bill.

Under federal law, a medical savings account (MSA) is a tax-exempt custodial account created exclusively for the benefit of the account holder. Within limits, contributions to an MSA are deductible in determining adjusted gross income. MSAs are available only to employees of a small employer who are covered under an employer-sponsored high deductible health plan, or to

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self-employed individuals covered under a high deductible health plan. After 2005, no new contributions can be made to MSAs except by or on behalf of individuals who previously had MSA contributions and employees who are employed by a participating employer.

Additionally, under federal law, individuals covered by a high deductible health plan are eligible to contribute to a Health Savings Account (HSA). HSAs are tax exempt trust or custodial accounts created exclusively to pay for qualified medical expenses of the account holder, his or her spouse, and dependents. Generally, contributions made by the account holder are deductible, and contributions made by an employer on behalf of a taxpayer are excluded from gross income and wages for employment tax purposes. Distributions from HSAs for qualified medical expenses are not includible in gross income. The maximum amount that can be contributed to an HSA is the lesser of: (1) the annual deductible under the high deductible health plan, or (2) the maximum deductible permitted for an MSA.

THIS BILL

This bill would provide, for taxable years beginning on or after January 1, 2006, a credit in an amount equal to the amount of costs paid or incurred by a taxpayer in connection with the purchase of a hearing aid. The device must be used by the taxpayer, his or her spouse, or his or her dependent. Eligible costs exclude:

- Amounts for which the taxpayer was reimbursed by his or her health care plan or health insurance,
- Amounts paid or distributed out of a taxpayer's or taxpayer's spouse's or dependent's medical saving account, or
- Amounts for which the taxpayer was reimbursed with funds paid or distributed out of a cafeteria plan that provides health benefits.

This bill defines a hearing aid as any wearable instrument or device designed for or offered for the purpose of aiding or compensating for impaired human hearing.

This bill provides that no deduction or credit can be claimed for the purchase of a hearing aid if another tax credit is taken for the same purchase. This bill also provides that in instances where the credit exceeds the taxpayer's net tax for the taxable year, the excess may be carried over to reduce the net tax in the following year and seven subsequent years, until the total credit is exhausted.

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.

- The bill's provisions contain no repeal date. Generally, tax credits are enacted with a repeal date to provide the legislature the opportunity to review the effectiveness and utilization of the credit.

- The definition of hearing aid provided in this bill is very broad, and feasibly, items such as headsets or earplugs could be included. Adding language to specify "medically prescribed hearing devices" may more accurately reflect the author's intent.

FISCAL IMPACT

This bill would require a calculation for the credit that would require a new worksheet to be developed. As a result, this bill would impact the department's printing, processing, and storage costs for tax returns. The additional costs will be identified and, if needed, an appropriation requested as the bill moves through the legislative process.

ECONOMIC IMPACT

Based on data and assumptions discussed below, revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 2698 Effective On Or After January 1, 2006 Enactment Assumed After June 30, 2006 ($ Millions)			
	2006-07	2007-08	2008-09
Hearing Aid Credit	-$200	-$225	-$250

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

<u>Revenue Discussion</u>

The number of taxpayers who would take advantage of this credit was estimated to be approximately 540,000 in California. Sources estimate about 30 million Americans have some hearing loss. It was assumed that of these 30 million with some hearing loss, about 50 percent need a hearing aid. Sources estimate that only $1/3^{rd}$ of those that need hearing aids actually get them. Because California has 12 percent of the U.S. population, it is assumed that 12 percent of these individuals with hearing aids reside in California. As most insurance policies do not cover the costs of a hearing aid, it was assumed 90 percent of those individuals getting hearing aids would not have any coverage for this expense. The estimate assumes that taxpayers claiming the credit would purchase new hearing aids once every four years. Therefore, it is estimated that approximately 135,000 Californians would qualify for this credit each year (30 million Americans x 50% x 1/3 x 12% California population x 90% x 1/4). The estimate also assumes that, starting in 2007 the number of people buying a hearing aid would increase 10 percent annually as taxpayers who need hearing aids and currently do not buy them, will decide to buy a hearing aid after considering the tax benefit.

Research indicates the average cost of a pair of hearing aids is approximately $2,200. For 2006, the value of qualified purchases is estimated to be approximately $300 million (135,000 Californians X $2,200 average cost). The estimate assumes that taxpayers will have sufficient tax liabilities to use only 60 percent of this credit. The total cost of this bill for calendar year 2006 is thus estimated to be $180 million ($300 million x 60%).

The estimate assumes that in 2007, in response to the credit, the average taxpayer will purchase hearing aids that are 10 percent more expensive than they would have absent the credit ($2,200 + 10% = $2,420). Also, the cost of hearing aids was assumed to increase at an annual rate of 5 percent to take into account increases in healthcare costs. Estimates provided in the table above have been converted to fiscal years.

LEGISLATIVE STAFF CONTACT

Deborah Barrett	Brian Putler
Franchise Tax Board	Franchise Tax Board
845-4301	845-6333
Deborah.Barrett@ftb.ca.gov	brian.putler@ftb.ca.gov