

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Maldonado Analyst: Raul Guzman Bill Number: SB 195

Related Bills: See Legislative History Telephone: 845-4624 Introduced Date: 02/10/2005

See Prior Analysis Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Provided Health Insurance Credit

SUMMARY

This bill would create a tax credit for taxpayers that provide health insurance for their employees.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to increase the number of people in this state that have health insurance.

EFFECTIVE/OPERATIVE DATE

This bill would be a tax levy and would be effective immediately upon enactment. It would be operative for taxable years beginning on or after January 1, 2005, and before January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal law, to which California conforms, the amount of an employer's contribution to an accident or health plan for the benefit of the employee or the employee's spouse or dependents is not includable in the employee's gross income.

Under federal law, a high deductible health plan (HDHP) for 2004 means a health plan with an annual deductible of at least \$1,000 for individual coverage (\$2,000 for family coverage) and maximum out-of-pocket expenses of \$5,000 for individual coverage (\$10,200 for family coverage.)

Under federal law, a health savings account (HSA) means a trust created or organized in the United States as a health savings account exclusively for the purpose of paying the qualified medical expenses of the account beneficiary. HSA's are available to individuals who are covered under a HDHP and are not covered under any other health plan, which is not a high deductible plan.

California has not conformed to the federal health savings account provisions.

Existing federal and state laws allow ordinary and necessary business expenses to be deducted, including health care coverage premiums paid by an employer for accident or health plans for employees.

Board Position:

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Department Director

Date

Gerald H. Goldberg

4/14/05

Existing federal and state laws also allow self-employed persons to deduct from gross income 100% of amounts paid for health insurance for themselves, spouses, and dependents.

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). Current state laws do not provide tax credits for any health care costs.

Federal law allows a refundable credit for the cost of health insurance equal to 65% of the expenditure. Individuals who are eligible for the credit are limited to the recipients of the following: Trade Adjustment Assistance (TAA), alternative TAA, or Pension Benefit Guaranty Corporation (PBGC) assistance. The cost to purchase health insurance for certain family members of the taxpayer may also qualify for the credit. Federal law provides minimum requirements for a health insurance plan, namely maximum deductible amounts.

THIS BILL

This bill would allow a credit of an unspecified percentage for amounts paid or incurred during the taxable year by a taxpayer that provides qualified health insurance for its employees. The credit would be available for taxable years beginning on or after January 1, 2005, and before January 1, 2007.

“Qualified health insurance” would mean:

- Amounts paid on behalf of employees to a high deductible health plan, or.
- A health savings account.

No credit would be allowed if a taxpayer has taken a deduction for health insurance for his or her employees in the preceding ten years.

This bill would allow unused credits to be carried over to future years until the credit is exhausted.

This bill would require the Franchise Tax Board to provide a report on the usage of this credit to the Legislature. The report would be due after the credit expires and would be required as soon as practicable for the department.

IMPLEMENTATION CONSIDERATIONS

A credit percentage would need to be specified before the department could administer this bill.

Many businesses have employees in more than one state. Currently, this bill would allow a credit for health insurance costs for employees that are employed by the taxpayer in other states or countries. If the author’s intent is to limit the health insurance cost to California employees, this bill would need to be amended. However, if the bill were limited to California employees, it would raise a constitutional issue, which is discussed below under Legal Impact.

LEGISLATIVE HISTORY

AB 995 (Canciamilla, 2005/2006) would create a tax credit for small employers that provide health coverage to their employees. This bill is scheduled to be heard in the Assembly Revenue and Taxation Committee on April 18, 2005.

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative sessions, AB 694 (Corbett) and AB 39 (Thomson/Campbell) from the 2001/2002 sessions were introduced creating an employer provided health insurance type credit. These bills failed passage in the Assembly.

SB 2260 (Stats. 1988, Ch. 1521) would have provided a small-employer health coverage tax credit; however, that credit was repealed before becoming operative.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. None of these states provides a credit comparable to the credit this bill would allow.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this measure, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of SB 195 Enactment Assumed After June 30, 2005 \$Millions			
	2005-6	2006-7	2007-8
Revenue Impact	-\$45	-\$55	-\$18

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The proposal did not specify a credit percentage. A discussion with the author's office indicated that the intent is to provide employers a tax benefit that would be somewhat better than if they treated the insurance costs as business deductions. For purposes of this analysis, a 10% credit was assumed. The remaining assumptions are based on a discussion with industry experts and on literature related to the California health care industry. Currently, an estimated 30% of employees in California do not have health insurance. Since the credit would be for two years and for 10% of the insurance costs, it was assumed that 10% of the uninsured employees would receive insurance due to the proposal. The average monthly premium costs for HMOs for 2004 was about \$260. The average premium for high-deductible health insurance was assumed to be about half of this amount or \$130 per month. A 10% growth rate was assumed for the premiums. Employers' share of the insurance costs was assumed to be 85%.

It was projected that only 55% of the qualified credit would be used due to insufficient income. The remaining 45% of unused credits can be carried over until used, and it is assumed that 20% will be used each subsequent year.

The revenue estimates include the costs of health savings accounts.

First-year revenue impact calculation:

Estimated number of employees without Insurance	4,000,000
Number insured due to the proposal (4,000,000 x10%)	400,000
Premium cost per employee (\$143 x 12 months)	\$1,700
Percent of premium picked up by employer	85%
Employers' insurance cost (400,000 x \$1,700 x 0.85%)	\$580 million
Amount of qualified credits (\$580 million @10%)	\$58 million
Percent of credits applied due to insufficient income	55%
Amount claimed (\$58 million x 55%)	\$32 million
Health savings accounts	\$5 million
Fiscal year split	\$8 million
Total liability impact	\$45 million

The adjusted figure was increased by \$5 million to account for the costs of health savings accounts. The additional \$8 million was calculated using the fiscal year split. The fiscal year split calculation takes into consideration the fiscal year loss attributable to the 2005 taxable year and portion of the 2006 taxable year. This adjustment assumes taxpayers would revise their estimate payments and adjust their withholding (or estimated payments) to allow for the credit.

LEGAL IMPACT

If this bill requires taxpayers to provide health insurance to employees located within California to qualify for this credit, the credit may be subject to constitutional challenge. The U.S. Court of Appeals for the 6th Circuit ruled in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738 that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. Ohio is seeking review by the U.S. Supreme Court. Although the outcome of this decision and its affects on the income tax credits of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

POLICY CONCERNS

This bill would allow the taxpayer a double benefit. This bill would allow a credit for a percentage of the taxpayer's health insurance expenses. Health insurance expenses are presently deductible by the taxpayer. Generally, credits require the related deduction to be reduced by the amount of the credit so that the taxpayer receives only one tax benefit.

This bill does not limit the number of years for the carryover period. 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 exhausted within eight years of being earned.

In addition, the bill as written does not address self-employed individuals. A self-employed person is not an employer or an employee. Consequently, the credit would not be allowed to a self-employed person.

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