Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	De Leon	Analyst:	Victoria Favorito	Bill Number:	AB 2940
Related Bills:	See Legislative History	Telephone:	845-3825	Amended Date:	April 10, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: California Employee Savings Program

SUMMARY

This bill would establish the California Employee Savings Program (CESP) under the administration of the California Public Employees' Retirement System (CalPERS) for the purpose of offering retirement savings opportunities to California's private sector employees.

SUMMARY OF AMENDMENTS

The bill as amended April 10, 2008, changed some of the provisions of the bill and clarified the establishment of the CESP.

The discussion in this analysis will primarily focus on the tax aspects for employers and employees who participate in retirement savings based plans. This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to create a supplemental retirement savings account that would allow employees the opportunity to participate in a convenient high return, low cost retirement savings plan.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2009.

POSITION

Pending.

Board Position:			Department Director	Date
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ANALYSIS

FEDERAL/STATE LAW

In General

Under federal and state law, an Individual Retirement Arrangement (IRA) is a personal savings plan that allows individuals to set aside money for retirement, while offering some of the following tax advantages:

- Individuals may be able to deduct some or all contributions to an IRA.
- Amounts in an IRA, including earnings, generally are not taxed until distributed.
- Amounts remaining in an IRA upon the individual's death can be paid to their beneficiary or beneficiaries.

Individual Retirement Arrangement (IRA)-based plans range from plans with little employer involvement to plans that the employer establishes and funds. The two types of IRA based plans are discussed below:

1. Payroll Deduction IRA, and
2. Savings Incentive Match Plan for Employees (SIMPLE) IRA

Payroll Deduction IRA

Under a Payroll Deduction IRA, an employee establishes an IRA (either a Traditional IRA or a Roth IRA) with a financial institution. The employee then authorizes a payroll deduction for the IRA.

Traditional IRA

To contribute to a traditional IRA, the individual must be under age 70 1/2 at the end of the tax year. An individual and/or spouse filing a joint income tax return must have taxable compensation such as wages, salaries, commissions, tips, bonuses, or net income from self-employment. Contributions to a traditional IRA may be tax deductible to the extent the contributions do not exceed the lesser of either: 1) the deductible amount for the year[1] or 2) the individual's compensation for that year that is includible in gross income. An individual may also elect to treat otherwise deductible contributions as a nondeductible contributions. In addition, the maximum allowable deduction may be reduced if the individual is an active participant in an employer plan. The portion of the contributions that is tax deductible is not subject to taxation until distributed. The earnings (i.e., interest and investment income) on the amounts in an IRA are also not taxed until distributed. Withdrawals made prior to age 59 ½ may be subject to an additional penalty tax.

[1] For 2007, the amount is $4,000 and $5,000 if catch-up contribution is allowable. For 2008, the amount is $5,000 and $6,000 for catch up-contribution.

Roth IRA

A Roth IRA is also a personal savings plan but operates differently. Contributions to a Roth IRA are not tax deductible. Like a traditional IRA, earnings build-up while in the account and are not subject to tax. Unlike a traditional IRA, the distributions (including earnings) from a Roth IRA are excluded from income.

SIMPLE IRA

Generally, a SIMPLE IRA plan must meet the requirements that apply to traditional IRAs. There are fewer restrictions in SIMPLE plans than other qualified retirement plans because SIMPLE plans are exempt from nondiscrimination rules and top-heavy rules.

The amount which an employee may elect for the employer to contribute is required to be expressed as a percentage of compensation and may not exceed the total of the applicable dollar amount for the year.[2] An employer can deduct its contributions and the employee's elective contribution to a SIMPLE plan. The deduction is generally allowed for the tax year in which the contributions were made.[3] Generally, an employee can exclude contributions from gross income and the income is not subject to income tax until distributed.

THIS BILL

This bill would establish CESP to be administered by CalPERS for California employees of participating private-sector or non-profit employers.

Under this bill, CESP must include one or more of the following for employees of participating employers:

- Payroll deposit IRA arrangements
- SIMPLE IRA plans
- Other IRAs

This bill would allow employers to participate in CESP and make contributions to their employees' IRA accounts.

This bill would allow participating employers to enroll their employees into CESP automatically and would allow employees who participate in the program to elect to designate a portion of their wages to CESP.

This bill would require the Employment Development Department to implement and maintain a payroll deduction program necessary to implement CESP.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

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[2] For 2007 and for 2008, the dollar limit for employee contributions to SIMPLE plans is $10,500.
[3] IRC section 404(m)(2)(A).

OTHER STATES' INFORMATION

Based on studies by CalPERS, retirement proposals similar to AB 2940 have been introduced in legislation recently in a number of states, including Connecticut, Maryland, Michigan, Vermont, and Washington. Currently, none of the proposals have been signed into law.

FISCAL IMPACT

No departmental costs are associated with this proposal.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses:

Estimated Revenue Impact of AB 2940 As Amended 04/10/2008 Effective for Tax Years on or after 1/1/2011 Enactment Assumed After 6/30/2008 ($ in Millions)		
2008-09	2009-10	2010-11
-	-	-$0.8

Estimates assume the CESP would be made available beginning 2011. This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The number of participating employers and employees, total contributions to the pension plan, investment returns, and marginal tax rate of those making contributions would determine the revenue impact of this bill.

The revenue impact of this bill is estimated as follows. According to the Bureau of Labor Statistics, 51% of private-sector workers—about 57 million people—participate in employer-sponsored retirement plans. This would leave 49%t of private-sector workers not participating in retirement plans. Applying this percentage to the 13 million Californian workers employed in the private sector in 2007 would result in 6.4 million California workers without an employer-sponsored retirement plan. It is assumed that the first year CESP would be available and employers participating in the CESP will incur no cost, 5% of eligible employers would participate. As more employers become familiar with CESP, it is assumed that more employers would participate. It is assumed participation would increase by 5% every year for the initial five years.

Based on a study performed by the State of Maryland and conversation with staff at CalPERS, it is assumed that between 18 and 24 months are needed before CESP is implemented. If this bill were enacted after June 30, 2008, it is assumed that CESP would become operative as of January 1, 2011. Given this date, the number of workers without an employer-sponsored retirement plan would be grown into 2011 and thereafter using the employment growth rate for California as indicated in the Governor's budget. The projection would be 6.7 million, 6.8 million and 6.9 million employees working for employers without a sponsored retirement plan for 2011, 2012, and 2013, respectively.

The number of employees working for a participating employer is estimated using the employer participation rate assumed above (5%) and the projected number of employees working for an employer that does not sponsor a pension. In 2011, 377,000 workers (5% x 6.7 million) would be working for employers who are eligible and choose to participate in CESP. Of the 377,000 employees, 67,000, or 20%, are assumed to participate in CESP (377,000 eligible employees x 20%).

Contributions to the plan are assumed to average $100 per month per employee for a total of $1,200 per year. It is also assumed that employees who choose to participate would enroll in CESP any month of the year and as such the first-year contributions for new enrollees would average $600 per year per employee. In the second year, all employees who enroll in the first year would make the full $1,200 contribution, while new enrollees in the second year would contribute an average of $600 per year. It is assumed this pattern would continue in subsequent years. In 2011, the first year of CESP, total contributions are estimated at $40 million and in 2012, the second year of CESP, total contributions increase to $120 million. For 2013 and 2014, contributions would total $196 million and $270 million, respectively.

Finally, a 5% reduction is applied to the total retirement contributions to account for money that would be put into retirement under CESP that could have been saved or invested and otherwise earned a taxable return in the form of interest and dividends. Once this adjustment is made, the revenue loss is estimated by applying a marginal tax rate of 6% to the adjusted contributions. For 2011, 2012, and 2013, the revenue losses would be $2.4 million, $7.2 million and $11.8 million, respectively.

Taxable year estimates are converted to fiscal year estimates in the table above. Since CESP is assumed to be operative in 2011, there would be no fiscal impact in 2008-09 and 2009-10.

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