Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Dymally | Analyst: Anne Mazur | Bill Number: AB 71

Related Bills: See Prior Analysis | Telephone: 845-5404 | Amended Date: June 12, 2007

Attorney: Tommy Leung | Sponsor: ____

SUBJECT: Employer Provided Health Insurance Credit/Small Business Health Care Tax Credit Act

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended April 9, 2007.

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

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 9, 2007, STILL APPLIES.

____ OTHER – See comments below.

SUMMARY

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

SUMMARY OF AMENDMENTS

The June 12, 2007, amendments revised the amount of the credit percentage to 25% of the amount paid by a qualified small employer during a taxable year for qualified health insurance expenses on behalf of qualified employees and revised definitions for those terms. The amendments also added new unspecified operative and repeal dates.

The Effective/Operative Date, This Bill, Implementation Considerations, Fiscal Impact, Economic Impact, Policy Concern have been revised to reflect the June 12, 2007, amendments and are provided below. The remainder of the department's analysis as amended April 9, 2007, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	6/15/07
____ N	____ OUA	_X_ PENDING		

PURPOSE OF THE BILL

According to the author's office the purpose of this bill is to provide a tax credit for small employers that provide health insurance coverage for low to moderate wage employees and are not covered by any other mandates or incentives.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would apply to taxable years beginning on or after January 1 of an unspecified year no earlier than 2010[1] and before January 1 of an unspecified year thereafter.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would allow a credit against franchise or income tax equal to 25% of the amount paid by a qualified small employer during a taxable year for qualified health insurance expenses for qualified employees.

This bill would define the key terms as follows:

- Qualified small employer – a small employer that offers health insurance coverage to all qualified employees and pays at least 50% of the cost of that coverage for each employee.
- Small employer – an employer that employed an average of more than one but fewer than 11 full-time and full-time-equivalent employees during the taxable year.
- Qualified health insurance expenses – amounts paid or incurred by an employer for health insurance coverage for a qualified employee and the employee's spouse, if applicable. Such amounts could not exceed $5,000 for each employee during the taxable year. A rule would be provided to determine qualified health insurance expenses for employers that provide coverage for dependents in addition to an employee and spouse. The bill would allow Franchise Tax Board (FTB) to prescribe any rules necessary for making this computation.
- Health insurance coverage – as defined under Internal Revenue Code (IRC) section 9832(b)(1), which generally includes medical care provided under any hospital or medical service policy, service plan contract, or health maintenance organization contract offered by a health insurance issuer. Certain excepted benefits[2] would not be treated as medical care.

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[1] Apparently it was not the author's intent to delay operation of the provisions of this bill until 2010 or later. Thus, it appears this is a drafting error.

[2] Excepted benefits generally include insurance coverage for accident, disability, or any supplement to liability insurance, workers compensation, automobile medical payment, credit-only, coverage for on-site medical clinics, and any other secondary or incidental insurance.

- Qualified employee means an employee of a qualified small employer who performed more than 50% of his or her services during a calendar year for the qualified small employer for compensation, as defined, within California. Such employee also must receive not more than $50,000 in total compensation from the qualified small employer during the taxable year. Employees that are covered under a spouse's plan, under any other individual or group plan, or a government subsidized plan, as defined, would not be a qualified employee.
- Compensation – amounts described in IRC section 3401(a) that, for purposes of withholding, defines "wages" as all remuneration for services performed by an employee, except as provided. This bill would require the $50,000 compensation limit to be adjusted annually to equal the income limits set for the Medi-Cal or Healthy Family programs.

This bill specifies that no deduction or other credit under any other provision would be allowed with respect to the qualified employee health insurance expenses taken into account for this credit. Any excess of the credit would be allowed to be carried over for up to seven years.

This bill provides that the FTB may prescribe rules and regulations as appropriate to implement and administer the credit.

The bill would provide for repeal of the credit provisions upon an unspecified date.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

The bill does not define the term "full-time-equivalent employees." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

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

Revenue Impact of AB 71 Assumed Enacted After June 30, 2007 Assumed Effective and Operative January 1, 2007 ($ in Millions)		
2007/08	2008/09	2009/10
– $110	– $165	– $225

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

Revenue Discussion

Based on data published by the Employment Development Department, it is estimated that approximately 850,000 employees work for firms that had more than one and fewer than 11 employees in 2007. Of these employees, about 170,000 receive health insurance coverage for self and 100,000 for self and family. Based on data from the California Health Interview Survey (CHIS), the 2007 cost was assumed to be $4,650 for employee only health care coverage and $9,300 for employee and spouse health care coverage. An annual growth rate of 8% was assumed for these health care costs.

Department staff assumed that the number of employees who receive health insurance coverage for self only would increase by 20% due to the incentive effect of the proposal. The tax benefit of providing health insurance for the employee and spouse is not as large. It was therefore assumed that the number of employees who receive health insurance for self and spouse would increase by 5% and the employers would receive credit for only $5,000 of the costs.

Based on the results of a survey conducted by the California Healthcare Foundation, it was estimated that employers pay 85% of the insurance costs for employees and 75% of costs[3] for employees and spouses. Including the incentive effects mentioned above, this results in approximately $1.3 billion of qualified healthcare costs for 2007, computed as follows:

170,000 × $4,650 × 1.20 × 0.85 = $805 million (self only coverage)
100,000 × $5,000 × 1.05 = $525 million (self and spouse coverage)
$805 million + $525 million = $1.33 billion

Under current law employers are allowed a deduction for their health care expenses. Staff assumed that under current law 90% of the $1.3 billion would be apportioned to California and 75% of the apportioned amount would be used due to sufficient income. Assuming a tax rate of 7.5%, this would result in a deduction amount of approximately $67 million under current law that would be lost under the proposed law:

$1.33 billion × 0.90 × 0.75 × 0.075 = $67 million

Under the proposed law the amount of qualifying credits at 25% would be $333 million (25% × $1.33 billion). Staff assumed that only 50% of this amount would be claimed as credit due to sufficient tax liabilities. This results in approximately $167 million of potential credits.

$333 million × .50 = $167 million

Taking into account the offsetting deductions results in a tax revenue impact of approximately $100 million.

$167 million – $67 million = $100 million

Unused credits are carried forward for seven years. The numbers in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

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[3] In any event, as noted, the maximum amount of cost eligible for the credit would be $5,000, which is less than 75% multiplied by the $9,300 total cost of employee and spouse health care coverage.

POLICY CONCERN

The bill references an IRC section to define the term "compensation." This definition would allow the compensation amount to be reduced by contributions to a 401(k) account – up to $15,500 for 2007 – for purposes of the compensation ceiling. This may allow an employee with greater than $50,000 in wages to be treated as a "qualified employee" for purposes of the credit provided by this bill, which may be inconsistent with the author's intent to provide health insurance coverage for low to moderate-wage employees.

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