Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Nakanishi/Smyth	Analyst:	John Pavalasky	Bill Number:	AB 84
Related Bills:	See Prior Analysis	Telephone:	845-4335	Amended Date:	March 12, 2007
		Attorney:	Tommy Leung	Sponsor:	

SUBJECT: Health Savings Account (HSA) Deduction Conformity

X DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 22, 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 INTRODUCED February 22, 2007, STILL APPLIES.

X OTHER – See comments below.

SUMMARY

Starting with taxable year 2008, this bill would allow the same deduction on California personal income tax returns for contributions to an HSA as is allowed on the federal personal income tax return for the taxable year.

SUMMARY OF AMENDMENTS

The March 12, 2007, amendments resolved the IMPLEMENTATION and TECHNICAL CONSIDERATIONS expressed in the analysis of the bill as introduced February 22, 2007. Those amendments conformed to the federal changes made to HSAs by the Tax Relief and Health Care Act (TRHCA) of 2006 (Public Law 109-432), enacted December 20, 2006, and made technical changes.

The discussion under THIS BILL is updated and a new revenue estimate is provided reflecting the March 12, 2007, amendments. The remainder of the previous analysis of the bill as introduced February 22, 2007, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	4/13/07
____ N	____ OUA	X PENDING		

THIS BILL

Starting with taxable year 2008, this bill would conform to the federal HSA provisions, as follows:

1. Allows the same above-the-line deduction for contributions to an HSA by or on behalf of an individual and adopts the rules applicable to the trust itself in order for the trust to be exempt from tax. In addition, the disqualified distribution penalty applicable to HSAs is modified for California purposes to be 2 ½% instead of the federal rate of 10% to be consistent with the other California penalty provisions applicable to IRAs. Consistent with general conformity policy in other areas, the federal 6% excise tax on excess contributions and the federal estate tax provisions are not being conformed to by this bill.

2. Allows the same exclusion from an employee's gross income for the amount of any contributions to an HSA (including salary reduction contributions made through a cafeteria plan) made on the employee's behalf by their employer.

3. Allows rollovers from Medical Savings Accounts (MSAs) to be made to HSAs, as well as rollovers between HSAs, without penalty.

4. Adopts the same $50 penalty for failure to make required reports.

5. Allows certain amounts in health flexible spending arrangements (FSA) or health reimbursement accounts (HRA) to be distributed from the health FSA or HRA and contributed through a direct transfer to an HSA without violating the otherwise applicable requirements for such arrangements.

6. Conforms to repeal of annual deductible limitation on HSA contributions.

7. Determines the Consumer Price Index for a calendar year as of the close of the 12-month period ending on March 31 of the calendar year (rather than August 31 as under prior law) for the purpose of making cost-of-living adjustments for the HSA dollar amounts that are indexed for inflation (i.e., the contribution limits and the high-deductible health plan (HDHP) requirements).

8. Allows individuals who become covered under a high deductible plan in a month other than January to make the full deductible HSA contribution for the year rather than being required to prorate the deduction based on the number of months the individual was enrolled in an HDHP.

9. Conforms to an exception to the comparable contribution requirements to allow employers to make larger HSA contributions for nonhighly compensated employees than for highly compensated employees. For example, an employer is permitted to make a $1,000 contribution to the HSA of each nonhighly compensated employee for a year without making contributions to the HSA of each highly compensated employee.

10. Allows a one-time contribution to an HSA of amounts distributed from an individual retirement arrangement (IRA). The contribution must be made in a direct trustee-to-trustee transfer. Amounts distributed from an IRA under these rules are not includible in income to the extent that the distribution would otherwise be includible in income. In addition, such distributions are not subject to the 2½% additional tax on early distributions.

Revenue Estimate

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

Estimated Revenue Impact for AB 84 Effective with Taxable Years BOA 1/1/08 ($ in Millions)		
2007-08	2008-09	2009-10
-$2	-$25	-$31

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 March 12, 2007, amendments expand HSA provisions to include provisions included in the federal TRHCA. Previous estimates for the bill as introduced were -$2, -$23, and -$29 million in 2007-08, 2008-09, and 2009-10, respectively.

The revenue impact of the bill as amended March 12, 2007, would be determined by (1) the amount of contributions to HSAs deducted on tax returns, (2) the amount of employer contributions to HSAs made on behalf of employees (including salary reduction contributions), (3) the amount of balances in Archer MSAs rolled over to HSAs, and (4) conforming to the expanded HSA provisions included in the TRHCA and marginal tax rates of taxpayers deducting or excluding such contributions.

1. For the 2004 taxable year, tax return data indicates 7,500 returns reflected HSA adjustments on Schedule CA totaling $20 million. This means that these taxpayers made tax-deductible contributions for federal purposes that were reversed for state purposes. Recent articles indicate the number of HSAs nationwide doubled during 2005 and again in 2006. To derive the estimates, this substantial growth rate is used through 2007 and is decreased thereafter to more sustainable rates. For 2008, contributions by California individual taxpayers to HSAs are estimated at $235 million. Applying a marginal tax rate of 7% results in a revenue loss of $16.4 million ($235 million x 7% = $16.4 million).

2. Contributions made by an employer on behalf of an employee (including salary reduction contributions made through a cafeteria plan) cannot be identified on a tax return. It is unknown how many additional HSAs may exist as a result of this contribution arrangement. Data indicate that 6% of employers offer HSA-eligible HDHPs. It is believed that most of these employers pay the premium for the HDHP rather than contribute to the employee's HSA. The rationale is that the premium is often less than the amount of the deductible that can be contributed to the HSA. In addition, HSA balances are portable and not owned by the employer. For purposes of an estimate, it is assumed that employer contributions on behalf of an employee are roughly one-quarter of that by individuals, or $59 million in 2008 ($235 million x 25% = $59 million). Applying a marginal tax rate of 7% results in an additional revenue loss of $4.1 million for 2008 ($59 million x 7% = $4.1 million).

3. The following is the estimate for the potential rollover of balances in Archer MSAs. For the 2002 taxable year, tax return data indicate deductible MSA contributions totaling $11.6 million reported on 4,600 returns. It is possible that balances in some MSAs have already been rolled over. In addition, there is no requirement that balances have to be rolled over. It is assumed that half of these accounts (2,300) would be rolled over and that each account has an average balance of $6,250. This balance equates to 2 ½ years of average contributions (2.5 years x $2,500 average annual contribution = $6,250). Applying a marginal tax rate of 7% results in a loss of an additional $1 million (2,300 x $6,250 x 7% = $1.0 million). It is anticipated that rollovers would likely occur in the initial one or two years of conformity. Therefore, the $1 million loss is divided between 2008 and 2009, or $0.5 million each taxable year.

4. For the expanded HSA provisions included in the TRHCA of 2006, estimates are based on a proration of federal estimates, with modifications. For these provisions, the conformity estimate is an additional loss of $2 million beginning with the 2008 taxable year.

For taxable year 2008, the estimate is a loss of $23 million ($16.4 million + $4.1 million + $0.5 million + $2 million = $23 million). Taxable year estimates are converted to cash flow fiscal year revenue estimates reflected in the table. For example, the 2007-08 cash flow estimate of a revenue loss of $2 million consists of only reduced estimated tax payments of an estimated $2 million for 2008 as the return for the 2008 taxable year is not required to be filed until April 15, 2009. The 2008-09 cash flow estimate of a revenue loss of $25 million consists of the remaining $21 million for 2008 ($23 million - $2 million = $21 million) plus $4 million loss for 2009 due to reduced estimated tax payments ($21 million + $4 million = $25 million).

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