Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nakanishi	Analyst:	Jennifer Bettencourt	Bill Number:	AB 85
Related Bills:	See Legislative History	Telephone:	845-4624	Introduced Date:	December 13, 2006
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT: Employer Provided Health Insurance Credit

SUMMARY

This bill would create a tax credit for taxpayers that provide qualified 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 who have health insurance.

EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately upon enactment and would be specifically operative for taxable years beginning on or after January 1, 2008, and before January 1, 2013.

POSITION

Pending.

ANALYSIS

FEDERAL LAW

Employer Deductions

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

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

Board Position:			Department Director	Date
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Employee Exclusion from Gross Income

The amount of an employer's contribution, including any salary reduction contribution made through a cafeteria plan, to an accident or health plan for the benefit of an employee or the employee's spouse or dependents, is excluded from the employee's gross income.

Health Savings Account Defined

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. HSAs are available to individuals who are covered under a high deductible health plan (HDHP) and are not covered under any other health plan that is not a high deductible plan.

High Deductible Health Plan Defined

Under federal law, an HDHP has:

- A higher annual deductible than typical health plans, and
- A maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that you must pay for covered expenses. Out-of-pocket expenses include co-payments and other amounts, but do not include premiums.

Medical Savings Account (MSA) Defined

Under federal law, an Archer MSA is a tax-exempt trust or custodial account that is established with a U.S. financial institution (such as a bank or an insurance company) in which money is saved exclusively for future medical expenses.

A Medicare Advantage MSA is an Archer MSA designated by Medicare to be used solely to pay the qualified medical expenses of the account holder who is eligible for Medicare. No Medicare Advantage MSAs have been established as of the revision date of this publication.

CALIFORNIA LAW

Current state law does not provide a tax credit for any health care costs. For tax years beginning on or after January 1, 1997, California conformed to the federal provisions for MSAs, and the law is generally the same. California does not conform to any of the federal HSA provisions, including the tax-free rollover from an MSA to an HSA.

Employer Deductions

California law conforms to the federal rules relating to ordinary and necessary expense deductions, such as employee wages paid and self-employed health insurance.

Employee adjustments to Federal Adjusted Gross Income

- The California personal income tax return starts with federal adjusted gross income (AGI) and requires adjustments to be made for differences between federal and California law. Adjustments relating to HSAs are required under current law, as follows:
- A taxpayer taking an HSA deduction on the federal personal income tax return is required to increase AGI on the taxpayer's California personal income tax return by the amount of the federal deduction.
- Any interest earned on the account is added to AGI on the taxpayer's California return.
- Any contribution to an HSA, including salary reduction contributions made through a cafeteria plan, made on the employee's behalf by their employer is added to AGI on the employee's California return.

THIS BILL

This bill would allow a 15% credit for amounts paid or incurred during the taxable year by a taxpayer that provides qualified health insurance for its employees who perform services in California. The credit would be available for taxable years beginning on or after January 1, 2008, and before January 1, 2013.

"Qualified health insurance" would mean:

- Amounts paid on behalf of employees to an HDHP, or
- An HSA.

"Qualified taxpayer" would mean:

- Any new small to medium size employer, or
- Any small to medium size employer that has not provided health insurance to their employees during the preceding five taxable years.

"Small employer" would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a public or private entity, employing at least 2 but not more than 19 persons.

"Medium employer" would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a public or private entity, employing at least 20 but not more than 199 persons.

This bill specifies the following:

- A deduction would not be allowed for the same expenses for which the credit is allowed.
- Any unused credits would be carried over to future years until the credit is exhausted.
- The Franchise Tax Board would provide a report on the usage of the credit to the Legislature, on or before September 1, 2011.
- The Legislative Analyst would provide a report on the effectiveness of the credit to the Legislature, on or before March 1, 2012.

This bill would allow the credit to Personal Income Tax Law taxpayers and Corporate Tax Law taxpayers.

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.

This bill would allow the credit to "public entities." The term "public entity" is undefined. If public entity is intended to refer to a governmental entity, the language is unnecessary because a governmental entity is not a taxpayer. It is suggested that public entities could be removed from the bill.

This bill specifies that FTB is to provide a report to the Legislature on or before September 1, 2011, on the usage of this credit, but is silent on the specific information that should be included in the report.

TECHNICAL CONCERNS

Amendment 1 has been provided to correct a technical error.

LEGISLATIVE HISTORY

SB 151 (Denham, 2007/2008) would allow a credit equal to the amount paid or incurred during the taxable year for qualified health expenses by a qualified employer. This bill is currently in the Senate Revenue & Taxation Committee.

SB 199 (Harman, et al., 2007/2008) would create a tax credit for certain taxpayers that provide qualified health insurance for their employees. This bill is scheduled for hearing in the Senate Revenue & Taxation Committee.

SB 2737 (Nakanishi), SB 1639 (Dutton), and SB 195 (Maldonado), from the 2005/2006 legislative session, were similar to this bill. These bills failed to pass out of the house of origin.

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative sessions, and 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.

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. *Illinois, Michigan, Massachusetts, Minnesota,* and *New York* conform to the federal deduction for contributions to HSAs. *Florida* has not conformed to the new federal HSA provisions for corporate income taxpayers and does not have a personal income tax.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Impact of AB 85 Enactment Assumed After June 30, 2008 ($ in Millions)			
	2007-08	2008-09	2009-10
Revenue Impact	-$4	-$22	-$36

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

Revenue Discussion

This estimate assumes that employers offering new HDHPs in response to this proposal would reduce the deduction for wages paid by an amount equal to the amount that they contribute to the new health plans. Employers will then use 15% of the contributed amount as a tax credit to reduce tax liabilities.

Using Employment Development Department data, it is projected that about 2 million employees would be working in qualified taxable small and medium size businesses during the 2008 taxable year. It is further assumed that 5%, or 100,000, of these employees would receive high-deductible insurance through their employers. Of these 100,000 employees:

- 66% or 66,000 would receive insurance only for themselves, and
- 34% or 34,000 would receive insurance for themselves and their dependents.

The average premiums for high-deductible health insurance are assumed to be $2,500 for employees and $5,700 for employees and dependents for the year 2008. A 10% annual growth rate is assumed for the premiums. Based on industry surveys, employers' share of the insurance costs is assumed to be:

- 88% for employees and
- 75% for employees and dependents.

The total qualified employers' cost for 2008, therefore, is projected to be approximately $290 million calculated as follows:

66,000 × $2,500 × 0.88 = $145.2 million Employees
34,000 × $5,700 × 0.75 = $145.3 million Employees and Dependents
$145.2 million + $145.3 million = $290 million Total Employer Cost (rounded)

The estimate assumes that this bill would increase the number of employees covered by new health plans by 6%. This would result in an additional insurance cost of $17 million incurred by the qualified employers for a total of $307 million ($290 million + $17 million). With a credit rate of 15%, the credit amount is projected to be $46 million for the 2008 taxable year (15% of $307 million). Approximately 75% of the credit amount would be absorbed by sufficient tax liability. As a result, this bill would allow a total of approximately $35 million in potential credits.

Under current law, an estimated $12 million is the revenue impact for deductions by employers for wages paid. The net revenue impact of this bill for the 2008 taxable year would be approximately $23 million ($35 million - $12 million). The chart above has been adjusted to reflect revenue estimates for fiscal years.

POLICY CONCERNS

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits are typically exhausted within eight years of being earned.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 85
As Introduced December 13, 2006

AMENDMENT 1

On page 4, line 7 after "authorized by" insert:

Sections