Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Denham	Analyst:	Jennifer Bettencourt	Bill Number:	SB 151
Related Bills:	See Legislative History	Telephone:	845-5163	Introduced Date:	January 29, 2007
		Attorney:	Tommy Leung	Sponsor:	

SUBJECT: Employer Provided Health Insurance Refundable Credit

SUMMARY

This bill would allow a refundable tax credit for qualified health expenses incurred during a taxable year by a qualified employer.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide an incentive for small businesses to provide health care coverage to their employees and to aid in the goal that every person in this state have health insurance.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal law allows self-employed individuals to deduct medical insurance premiums paid for employees, and 100% of the cost to purchase medical, dental and qualified long-term care insurance for themselves, spouses, and dependents. The insurance plan must be established under their business.

Current state laws provide various credits for personal income tax that reduce the tax and have either refundable or carryover provisions. Corporate tax laws provide various credits that reduce the tax and in some instances have carryover provisions. Generally, these credits are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. Current state law lacks a comparable credit to the one proposed by this bill.

Board Position:			Department Director	Date
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THIS BILL

This bill would provide, for taxable years beginning on or after January 1, 2008, a credit equal to 100% of the amount paid or incurred during the taxable year for qualified health expenses by a qualified employer.

"Qualified employer" would mean a small business as referenced by Government Code Section 13340 that is defined as a small business that is independently owned and operated, and not dominant in its field of operation. The principal office must be located in California, and the officers must be domiciled in California. Together with affiliates, a small business must have 100 or fewer employees, and average annual gross receipts of ten million dollars or less, over the previous three years. A small business would also include a manufacturer, with 100 or fewer employees, that is primarily engaged in the chemical or mechanical transformation of raw materials or processed substances into new products.

This bill would also define qualified health expenses as the total amount a qualified employer paid or incurred during the taxable year for health insurance and health care service plans for its employees.

This bill would disallow any other credit or deduction under other provisions for qualified health expenses when a credit is taken under this provision.

This bill would require any credit amount that exceeds the taxpayer's liability be refunded. Funds would be continuously appropriated from the General Fund to the Controller to issue refunds.

This credit would be repealed as of December 1, 2013.

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.

- Creating a refundable credit for taxpayers subject to tax under Part 11 of the Revenue and Taxation Code would be unprecedented. As a result, the department's corporation processing systems would need to be significantly modified. It is expected that the department costs associated with the extensive changes would be substantial.
- There is no existing statute in the Corporation Tax Law that specifies the order in which corporate tax credits are to be applied against net tax. Without a clear statutory rule, a taxpayer may argue that they are entitled to apply non-refundable credits before refundable credits, thereby increasing their net refunds.
- Under current law, credits cannot reduce the alternative minimum tax and the $800 minimum franchise tax. The practical effect of making the credit refundable would be to allow the credit to offset the minimum franchise tax and the corporate alternative minimum tax.

- This bill would be unclear whether taxpayers that are pass-through entities (partnerships, limited liability companies, and S corporations) could claim the credit and receive a refund or whether the entity must pass the entire credit to its investors (partners and shareholders), or whether both the entity and their investors would be entitled to a refund of the credit amount.
- This bill would allow a credit for amounts paid or incurred for "health insurance and health care service plans for its employees," yet, fails to define these terms and is not linked to amounts that would otherwise be allowed as a deduction by the qualified employer. To avoid disputes between taxpayers and the department, the author may wish to amend the bill to specify and define what constitutes health insurance and health care service plans.
- This bill would rely on Government Code provisions for the definition of a small business; however, the definition is ambiguous and needs further clarification for tax purposes. Specifically, phrases such as "affiliate" and "independently owned and operated" are undefined and have no specific relation to this bill as written. The author may wish to amend the bill to define and give specific qualifications to be considered a "small business" and require certification per the Government Code.

LEGISLATIVE HISTORY

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative session, and AB 694 (Corbett, 2001/2002), would have created a type of employer provided health insurance credit. These bills failed passage in the Assembly.

AB 995 (Canciamilla, 2005/2006) and AB 39 (Thomson/Campbell, 2001/2002) would have allowed a refundable credit of 50% of the total amount paid or incurred for health coverage for an eligible individual and that individual's dependent or dependents. These bills failed passage in the Assembly.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of SB 151 Effective 1/1/08 with Enactment after 6/30/07 ($ in Billions)			
2007-08	2008-09	2009-10	2010-11
-	- $10	- $10	- $10

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

Revenue Discussion

The revenue impact of this bill would depend on the number of employees in small firms who are offered employer-provided health insurance and the cost of premiums. Because the refundable credit would pay for the entire cost of insurance, it is assumed most small employers would avail themselves of this credit. It is estimated that there will be over 4 million employees working for small businesses in 2008 that would qualify the employers for this credit.

The average cost of premiums per employee is projected to be over $5,000 for individual coverage, and more than $10,000 for family coverage. Assuming half of the employees would choose family coverage and half would choose individual plans, the expected cost is well over $10 billion per year. (2 million x $5,000 + 2 million x $10,000)

ARGUMENTS/POLICY CONCERNS

Generally, credits are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

As discussed above in the implementation concerns, the definition of “small business,” as reflected in the Small Business Procurement Act of the Government Code, may include concepts that could operate contrary to the author’s intent.

LEGAL CONCERNS

The Government Code definition of "small business" restricts this credit to small businesses located in California and requires officers of the business to be domiciled in this State. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to favor in-state businesses. For example, an out-of-state business with employees who perform services in California, file a state tax return, and pay tax on income sourced within the state, would be unable to claim this credit because they cannot satisfy the “principal office located in California” and “officers domiciled in California” requirements of the bill.

LEGISLATIVE STAFF CONTACT

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