Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Ashburn	Analyst:	Anne Mazur	Bill Number:	AB 820
Related Bills:	See Prior Analysis	Telephone:	845-5404	Amended Date:	May 15, 2007
		Attorney:	Tommy Leung	Sponsor:	

SUBJECT: Employer Cafeteria Plan Administrative Costs Credit/FTB Report To Legislature On Or Before January 1, 2011, Regarding Utilization Of Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________________.

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

X AMENDMENTS DID NOT RESOLVE ALL OF THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as amended April 9, 2007.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

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

X OTHER – See comments below.

SUMMARY

This bill would permit a credit against franchise and income tax for administrative costs associated with establishing or administering a "cafeteria plan."

SUMMARY OF AMENDMENTS

The May 15, 2007, amendments made the following changes to the bill:

- Added costs in connection with administering a cafeteria plan as costs that would be eligible for the credit.
- Added a definition of the term "employer."
- Added new operative and repeal dates.
- Added a requirement for Franchise Tax Board (FTB) to report on the utilization of the credit to specified legislative committees.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	8/8/07
____ N	____ OUA	X PENDING		

The May 15, 2007, amendments resolved several, but not all, of the implementation and policy concerns discussed in the department's analysis of the bill as amended April 9, 2007. The amendments resolved the department's implementation concerns regarding the lack of clarity of the terms "employer" and "establishing." Revised Effective/Operative Date, This Bill, Implementation Considerations, Technical Considerations, Economic Impact, and Policy Concerns sections are provided below. The remainder of the department's analysis of the bill as amended April 9, 2007, still applies.

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, 2007, and before January 1, 2012.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would establish, under both the personal income tax law and the corporation tax law, a credit against franchise or income tax in the amount of 15% of administrative costs incurred by a qualified taxpayer in connection with establishing or administering a cafeteria plan that provides for the payment of health insurance premiums of the taxpayer's employees.

The bill would define the term "qualified taxpayer" as an employer, meaning any individual or entity that is doing business in California, that is deriving income from California sources or is subject to the laws of California. The term "employer" also means the State of California and all of its political subdivisions, Regents of the University of California, any other political body or agency of the state, and any person, officer, employee, department, or agency paying wages to employees for services performed within California.

The bill would deny a deduction for any portion of expenses for which the credit is allowed and would not allow this credit for expenses for which any other credit under the personal income tax or corporation tax law was allowed. The bill would also allow any unused credit to be carried over for seven years.

The bill would require FTB to provide a report on the utilization of the credit to the chairs and vice chairs of the Senate and Assembly Health Committees and the Senate and Assembly Revenue and Taxation Committees. The report is required to be submitted on or before January 1, 2011, and must provide information regarding the effectiveness of the credit, including the amount of the credit claimed, an estimate of the number of Internal Revenue Code (IRC) Section 125 cafeteria plans established, and the number of employees affected, and information regarding the types of benefits offered by these plans.

The bill would repeal the credit on December 1, 2012.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this concern and other concerns that may be identified.

The bill does not define the term "administrative costs." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit. It is suggested that the bill be amended to provide a definition for this term.

TECHNICAL CONSIDERATION

The bill's definition of the term "employer" should be revised. The bill language applies the "making payments of wages to employees for services performed within this state" element of the definition to government entities in the second sentence of the paragraph, but not to the "person, corporation, association or limited liability company" list in the first sentence. On page 2, lines18 and 19, and on page 3, lines 29 and 30, strikeout "state. "Employer" also includes" and insert "state," to correct this problem.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Personal Income Tax and Corporation Tax revenue impact from this bill would be as follows:

Estimated Revenue Impact of SB 820 Effective 1/1/07 with Enactment After 6/30/07 ($ in Millions)		
2007/08	2008/09	2009/10
− $5	− $56	− $63

This bill 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 depends on the amount of qualified cafeteria plan tax credits that would be applied to reduce employer income or franchise tax liabilities.

The estimated average cost of establishing a qualified cafeteria plan is $1,425, which is comprised of $425 average fee paid to a third party plus $1,000 internal administrative costs. Employers' costs associated with ongoing plan administration are estimated at $40 per employee per year.

Based on California Employment Development Department reports, it is estimated that the average number of businesses during 2007 will be approximately 1.3 million. Data from various sources indicate the percentage of businesses currently offering cafeteria plans that provide for the payment of employee health insurance premiums is approximately 30%. Therefore, it is projected approximately 390,000 businesses will offer qualifying section 125 plans to their employees during 2007. (1.3 million x 30% = 390,000.) Using the same data sources, it is estimated approximately 357,000 businesses offered qualifying section 125 plans during 2006. New businesses offering cafeteria plans would number approximately 33,000 during 2007. (390,000 businesses offering plans during 2007 – 357,000 businesses offering plans during 2006 = 33,000 new businesses offering cafeteria plans during 2007.) Using the estimated average cost of $1,425, the cost to new businesses offering qualified cafeteria plans during 2007 is approximately $47 million. ($1,425 x 33,000 new plans = $47 million.)

Based on California Department of Finance reports, it is estimated the average number of non-governmental California employees at approximately 12.8 million for 2007. Based on various data, it is estimated 50% of these employees have access to a cafeteria plan that provides for the payment of health insurance premiums and 60% of these employees participate in the plans. Using the estimated average cost of $40 per participating employee, the estimated cost to employers for internal administrative costs during 2007 is approximately $154 million. (12.8 million employees x 50% with access to qualified cafeteria plans x 60% participation rate x $40 cost per participating employee = $154 million.)

Additional costs to administer a qualified cafeteria plan may include fees charged by banks, investment companies, insurance companies, retirement plan administrators, and other providers that may independently provide service to the qualified cafeteria plan. These additional costs are assumed to average approximately $100 per qualified cafeteria plan. Additional qualifying costs are estimated at approximately $39 million. (390,000 employers with qualified cafeteria plans x $100 average miscellaneous fees per employer = $39 million.)

Total available credits related to establishing and administering qualified cafeteria plans for California employees would be approximately $36 million for 2007. ($47 million to establish plan + $154 million ongoing internal administrative costs + $39 million miscellaneous costs = $240 million qualifying costs. $240 million x 15% = $36 million.)

This bill would not limit the credit to costs incurred for California employees, nor would it apply an apportionment percentage to the credit. It is estimated approximately 25% of employees participating in qualified cafeteria plans work for apportioning corporations. Therefore, approximately $9 million of the credit calculated above would be generated from costs associated with California employees who work for apportioning corporations. ($36 million x 25% = $9 million.) Based on FTB statistics, the average apportionment factor tends to be about 10%. Assuming a 10% apportionment factor applied to payroll, these apportioning corporations should generate total credits of $90 million ($9 million credit for California employees divided by 10% apportionment.) This results in total available credits of $117 million. ($36 million – $9 million + $90 million = $117 million.)

Employers may currently deduct the costs of establishing and administering cafeteria plans. This bill would not allow deduction of any costs for which the credit is allowed. Because the average tax rate of 7.5% is 50% of the 15% credit percentage, the value of the credit, after taking into account the offsetting loss of deductions, is approximately 50% the amount of the credit, or $14 million, for credits of non-apportioning businesses. ($36 million - $9 million = $27 million. $27 million x 50% = $14 million.) After taking into account the offsetting loss of deductions, the value of the credit for apportioning corporations is approximately 95% of the amount of the credit or $86 million. The deduction offset for apportioning corporations is calculated as follows: $90 million credits divided by 15% credit percentage = $600 million qualifying costs. $600 million qualifying costs x 10% apportionment factor = $60 million. $60 million qualifying costs apportioned to California x 7.5% average tax rate = $4.5 million lost deductions. ($90 million - $4.5 million = $85.5 million, which is rounded to $86 million.)

Of credits generated, it is assumed 50% would be applied in the tax year generated and another 30% would be applied during the carryover period. Total revenue loss for tax year 2007 is estimated at approximately $50 million. ($14 million value of credits associated with non-apportioning businesses + $86 million value of credits associated with apportioning corporations = $100 million. $100 million x 50% credits applied = $50 million.)

It is assumed this bill would not increase the number of employers offering qualified cafeteria plans. Also, it is assumed that administrative fees actually paid by employees (through payroll deduction) would not qualify for the credit.

Estimates in the table above have been converted to fiscal year cash flows.

ARGUMENTS/POLICY CONCERNS

The bill appears to require qualified taxpayers to have California employees, but does not limit eligible costs to those allocable to such employees. Therefore, employers could claim the credit for costs attributable to non-California employees, which may be inconsistent with the policy objective the author is trying to achieve.

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