Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nakanishi	Analyst:	Jennifer Bettencourt	Bill Number:	ABX1 5
Related Bills:	See Legislative History	Telephone:	845-5163	Introduced Date:	September 18, 2007
		Attorney:	Douglas Powers	Sponsor:	

SUBJECT: Employer Provided Health Insurance Credit/FTB Report To Legislature On Or Before December 1, 2011, Regarding Usage & Effectiveness Of 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

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 ordinary and necessary business expenses to be deducted, including health care coverage premiums paid by an employer for accident or health plans for employees and allows self-employed persons to deduct from gross income 100% of amounts paid for health insurance for themselves, spouses, and dependents. California law conforms to both of these provisions.

Under current federal law, the amount of an employer's contribution to an accident or health plan for the benefit of an employee or the employee's spouse or dependents, including any salary reduction contribution made through a cafeteria plan, is excluded from the employee's gross income. California law also conforms to this provision.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Lynette Iwafuchi	1/22/08
_______ N	_______ OUA	___x___ PENDING	for Selvi Stanislaus	

For taxable years beginning on or after January 1, 1997, California conformed to the federal provisions that allow an individual to deduct contributions to an Archer Medical Savings Account (MSA); however, California does not conform to any of the federal Health Savings Account (HSA) provisions, including the tax-free rollover from an MSA to an HSA.

THIS BILL

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

This bill defines the following terms:

- "Qualified taxpayer" would mean:
  - Any new small to medium size employer, or
  - Any existing small to medium size employer that has not provided health insurance to their employees during any of the five taxable years immediately preceding the taxable year.
- "Qualified health insurance" would mean amounts paid on behalf of employees to:
  - A High Deductible Health Plan (HDHP) as defined by Internal Revenue Code (IRC) section 223(c)(2), or
  - A Health Savings Account as defined by IRC section 223(d).
- "Small employer" would mean a person, as defined in Section 7701(a) of the IRC, or a 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 IRC, or a private entity, employing at least 20 but not more than 199 persons.
- "New small to medium employer" would mean a small or medium employer created on or after October 1, 2008.

This bill would specify that this credit would be allowed in lieu of any deduction for the same expenses. Any unused credits could be carried over to future years until the credit is exhausted.

This bill would require that on or before December 1, 2011, the Franchise Tax Board would provide a report to the Legislature to include the following:

- The total number of employees using the credit allowed under this provision,
- The total number of employees who have enrolled in high deductible health plans since the inception of the credit, and
- The total cost of this credit to the state.

This bill would allow the credit to both personal and corporate income taxpayers .

IMPLEMENTATION CONSIDERATIONS

This bill would require a qualified taxpayer to pay income tax to this state in order to qualify for the credit. Requiring that income tax is actually "paid" could result in disputes because some taxpayers have no tax liability and thus, would not qualify for the credit. The author may wish to amend the bill to eliminate or modify the "paid taxes to this state" criteria.

This bill defines small and medium employer as a person, as defined in Section 7701(a) of the IRC or a private entity employing a specified number of persons. Section 7701(a) defines "person" as an individual, trust, estate, partnership, association, company, or corporation., Use of the word "private entity" is redundant, thus it is recommended that it be deleted from the language. Furthermore, it is recommended that the term "persons" be replaced with "individuals" because the legal definition of "person" includes business entities.

LEGISLATIVE HISTORY

AB 85 (Nakanishi, et al., 2007) was identical to this bill and failed to pass the Assembly Revenue & Taxation Committee.

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative session, and AB 694 (Corbett) and AB 39 (Thomson/Campbell), from the 2001/2002 session, would have created an employer provided health insurance credit. These bills failed passage in the Assembly.

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

SB 199 (Harman, et al., 2007/2008) would have created a tax credit for certain taxpayers that provide qualified health insurance for their employees. This bill failed to pass 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 Senate.

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* does not have a personal income tax and has not conformed to the new federal HSA provisions for corporate income taxpayers. .

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 ABX1 5 Enactment Assumed After January 1, 2008 ($ in Millions)			
	2007-08	2008-09	2009-10
Revenue Impact	-$4	-$23	-$37

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

Revenue Discussion[1]

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 approximately 2.2 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 110,000, of these employees would receive high-deductible insurance through their employers. Of these 110,000 employees:

- 66% or 72,600 would receive insurance only for themselves, and
- 34% or 37,400 would receive insurance for themselves and their dependents.

[1] For AB 85 (Nakanishi et al., 2007), which was identical to this bill, the department's revenue estimate was based on 10% annual growth rate for premiums. This revenue estimate is slightly less because department staff used a 7% growth rate which is consistent with the Governor's Health Care Reform Proposal.

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 7% 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:

Employees: 72,600 × $2,500 × 0.88 = $160 million

Employees and Dependents: 37,400 × $5,700 × 0.75 = $160 million

Total Employer Cost: $160 million + $160 million = $320 million (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 $20 million incurred by the qualified employers for a total of $340 million ($320 million + $20 million). With a credit rate of 15%, the credit amount is projected to be $50 million for the 2008 taxable year (15% of $340 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 $38 million ($50 million x .75) in potential credits.

Under current law, an estimated $13 million is the revenue impact for deductions currently claimed by employers for wages paid, calculated as follows:

- An estimated 90% of $320 million is assumed to be apportioned to California. It is projected that only 75% of the apportioned amount would be deducted due to sufficient tax liability. Assuming a tax rate of 6%, this would result in an estimated $13 million of tax revenue impact under current law.
- It is assumed that an additional $1 million in deductions would be claimed under the provisions of this bill. This results in a total revenue impact of $14 million for deductions.

The net revenue impact of this bill for the 2008 taxable year would be approximately $24 million ($38 million - $14 million). The chart above has been adjusted to reflect revenue estimates for fiscal years.

POLICY CONCERNS

This bill would include any new small or medium employer created on or after October 1, 2008, as a qualified taxpayer. An existing employer could change the form of how it conducts its business to become a "new" corporation, which may not meet the author's intent. For example, a Limited Liability Company created from an existing sole proprietorship could claim to be "new." The author may wish to amend the bill to include language similar to that contained in current net operating loss provisions, which would eliminate the ability of taxpayers to circumvent this limitation.

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Generally, credits include a carryover period limitation because experience shows credits are typically exhausted within eight years.

LEGISLATIVE STAFF CONTACT

Jennifer Bettencourt
Franchise Tax Board
(916) 845-5163
jennifer.bettencourt@ftb.ca.gov

Bagher Modjtahedi
Franchise Tax Board
(916) 845-5243
bagher.modjtahedi@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov