Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	DeSaulnier	Analyst:	Matthew Cooling	Bill Number:	SB 1071
Related Bills:	See Legislative History	Telephone:	845-5983	Amended Date:	April 27, 2010 & April 28, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Prescription Drug Credit/Persons 55 Or Older

SUMMARY

This bill would establish both a credit for costs paid or incurred by seniors for prescription drugs and a tax for the manufacturing or importing of prescription drugs, as specified.

This analysis will address the bill's changes to the provisions pertaining to the excise tax on prescription drugs only as they impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The April 27, 2010, amendments added a credit for costs paid or incurred by seniors for the purchase of prescription drugs. The amendments also removed language providing a fee on prescription drugs and replaced it with a $0.0025 excise tax on each pill manufactured or imported and prescribed to an individual.

The April 28, 2010, amendments removed a provision that limited the sale of manufactured controlled substances and added tax levy language to the bill.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the legislative findings in the bill, the purpose of this bill is to impose a tax on manufacturers and importers of Schedules II, III, and IV controlled substances[1] to mitigate the misuse, abuse, and trafficking of these types of drugs with the intent of ensuring that the bill does not produce a net revenue gain in state taxes.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and specifically operative for taxable years beginning on or after January 1, 2011, and before January 1, 2016.

[1] Controlled substances are determined under the federal Food and Drug Code and administered by the U.S Drug Enforcement Administration. A schedule of such controlled substances can be viewed at http://www.deadiversion.usdoj.gov/schedules/orangebook/e_cs_sched.pdf

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	05/11/10
_______ N	_______ OUA	___X___ PENDING		

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal law, to which California conforms, specifically allows unreimbursed medical care expenses, including costs for certain medicine and drugs, to be deducted for income tax purposes. The expenses may be claimed as an itemized deduction only to the extent that they exceed 7.5 percent of the taxpayer's adjusted gross income (AGI)[2]. Federal law provides that costs for medicine and drugs may be deducted if the medicine or drug is prescribed or is insulin.

Current federal and state laws contain various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

THIS BILL

For taxable years beginning on or after January 1, 2011, and before January 1, 2016, this bill would allow a tax credit to taxpayers 55 years of age or older equal to the unreimbursed amounts paid or incurred for the taxpayers' own medicine or drugs.

The taxpayers' "own medicine or drugs" means medicine or drugs as described by Section 213(b) of the Internal Revenue Code.[3]

This bill would require that the credit be claimed on an original, timely-filed tax return.

This bill would impose a new excise tax on manufacturers and importers of Schedules II, III, and IV controlled substances under Section 70003 of the Revenue and Taxation Code. The tax would be equal to $0.0025 per pill that is manufactured or imported and would be administered by the Board of Equalization (BOE). This bill would also limit the total amount of credits allowed under this bill to an amount that does not exceed the amount of excise tax collected by the BOE for any taxable year.

This bill would require the Franchise Tax Board (FTB) and BOE in exchanging information to ensure that the total amount of credits allowed does not exceed the total excise taxes collected by the BOE under this bill, so as not to produce a net revenue gain to the state for any taxable year.

---

[2] For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.
[3] Internal Revenue Code 213(b) specifies that certain medical expenses are deductible "if such medicine or drug is a prescribed drug or insulin."

This bill would allow the FTB to prescribe rules, guidelines, or procedures to administer this credit, and would further allow such rules, guidelines, or procedures to be exempt from the Administrative Procedure Act. This bill would also provide funding to the FTB, upon appropriation by the Legislature, for the administrative costs incurred for administering this credit.

This bill would allow any unused credit to be carried over for seven years or until exhausted.

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 require the FTB and the BOE to coordinate efforts to ensure that the total credits proposed by this bill do not exceed the excise tax proposed by this bill, as specified. Each department administers the assessment and collection of tax under the Revenue and Taxation Code in various ways.[4] It is unclear how each department would coordinate efforts to time the interaction of the excise tax and personal income tax credit to comply with the provisions proposed by this bill. Lack of direction to the BOE and the FTB regarding the collection of the tax and allowance of the credit could lead to disputes among both departments and the taxpayers. It is recommended that the author amend the bill to provide specific direction to the BOE and the FTB to the coordinate their responsibilities related to the interaction between the excise tax and the personal income tax credit proposed by this bill.

This bill would allow taxpayers to claim a credit for the unreimbursed costs paid or incurred for prescription drugs purchased by the taxpayer during the taxable year. It is unclear how the FTB would determine which costs are unreimbursed to the taxpayer. Due to the relatively small amounts paid for each prescription, monitoring whether an expenditure qualifies for the credit could be costly for the department. Lack of clarity could lead to disputes between taxpayers and the FTB. It is recommended that the author amend the bill to include language that would specify how the taxpayer would certify that the costs paid for the prescription drugs were unreimbursed by any public or private health insurance plan or other third party.

LEGISLATIVE HISTORY

AB 1166 (Campbell, 2001/2002) would have created a 25 percent credit for seniors 65 years of age or older for the costs of prescription drugs. This bill was held in the Assembly Revenue and Taxation Committee.

SB 155 (Oller, 2001/2002) would have allowed a refundable credit to individuals 55 years of age or older for 100 percent of their prescription drugs that were not reimbursable by a third party. This bill was held in the Senate Revenue and Taxation Committee.

---

[4] In general, the BOE assesses and collects excise taxes quarterly while the FTB assesses tax based on a 12-month period determined by the taxpayer and collects the tax assessed at the end of that period.

AB 2533 (Pacheco, 1999/2000) would have allowed a 25 percent prescription drug credit limited to specified annual maximum amounts. This bill was held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

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

FISCAL IMPACT

This bill would require the department to monitor the credit through an allocation or certification process. As a result, this bill would impact the department's printing, processing and storage costs for administering the credit. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1071 Effective For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed September 30, 2010 ($ in Millions)		
2010-11	**2011-12**	**2012-13**
-$150	-$1,800	-$2,100

The total expenditure for this credit would be limited to the revenue generated by a new proposed tax under Section 70003 of the Revenue and Taxation Code. Because the revenue for the tax as specified in this bill is being estimated by another department, this estimate represents the maximum revenue loss, without regard to any limitations.

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

ARGUMENTS/POLICY CONCERNS

The intent of this bill is to limit the amount of tax credits granted to taxpayers by the amount of the excise tax proposed as a way to limit the overall revenue impact. It is difficult to estimate if the bill would remain revenue neutral because the department is unable to determine if the taxpayers would take advantage of the credit as intended. If taxpayers fail to claim the credit to its full extent, there would be an overall revenue gain attributed to the excise tax.

In addition, if the credit matches the amount of tax collected, the credit would cease to be operative; however, the tax would continue to be imposed. If the author's intent is to prevent a revenue gain by imposing the tax and offsetting it with a credit, the bill should be amended to state that the credit shall not be less than the tax proposed by this bill.

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis. This bill would provide a 100 percent credit, which would be unprecedented.

This bill would allow taxpayers to claim a credit for the unreimbursed costs paid or incurred for prescription drugs purchased by the taxpayer during the taxable year. These costs are currently deductible as medical expenses if the taxpayer's medical expenses exceed 7.5 percent of the AGI. Generally, a credit is allowed in lieu of a deduction to eliminate multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

Legislative Analyst	Revenue Manager	Asst. Legislative Director
Matthew Cooling	Monica Trefz	Patrice Gau-Johnson
(916) 845-5983	(916) 845-4002	(916) 845-5521
matthew.cooling@ftb.ca.gov	monica.trefz@ftb.ca.gov	patrice.gau-johnson@ftb.ca.gov