

Author: Aanestad Analyst: Deborah Barrett Bill Number: SB 92  
 Related Bills: See Legislative History Telephone: 845-4301 Amended Date: January 21, 2009, February 25, 2009 & March 11, 2009

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Health Care Services Offsets/Health Insurance Premiums Credit/FTB Report To Leg 9/1/13/ Physicians Uncompensated Medical Care, Primary Care Provider & Qualified Medical Care Professionals Credits/Health Savings Account & Medical Care Deduction Conformity

**SUMMARY**

This bill would do the following:

- Allow tax credits for the following:
  - Health insurance expenses for taxpayer and dependents;
  - Employer expenses to provide health care to employees;
  - Qualified medical care professionals, as defined;
  - Uncompensated medical care provided by a physician, as defined;
  - Primary care provider performing services in a rural area, as defined;
- Allow a deduction for contributions to a Health Savings Account (HSA) and certain medical expenses, and
- Require Franchise Tax Board (FTB) to offset tax refunds for unpaid medical services provided by hospitals and health care providers.

Provisions of the bill that affect the Business and Professions Code, the Financial Code, the Government Code, the Health and Safety Code, the Insurance Code, the Labor Code, and the Welfare and Institutions Code that do not impact FTB are not discussed in this analysis.

**SUMMARY OF AMENDMENTS**

The January 21, 2009, amendments introduced the provisions related to credits, deductions, and refund offsets. The February 25, 2009, amendments added provisions defining the term “medical necessity” and “medically necessary,” and renumbered the bill sections. The February 25, 2009, and March 11, 2009, amendments do not impact FTB and are not discussed in this analysis. The “This Bill”, “Implementation Consideration”, and “Economic Impact” of each provision in the bill are discussed separately.

This is the department’s first analysis of this bill.

Board Position: _____ S      _____ NA      _____ NP _____ SA      _____ O      _____ NAR _____ N      _____ OUA      _____ X PENDING	Department Director      Date  Selvi Stanislaus      05/20/09
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## PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to provide urban and rural safety nets for the uninsured, remove the "sick tax" created by not conforming to the federal HSA provisions, and remove incentives to remain uninsured.

## EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and as prescribed by its own terms, the following provisions of this bill would be expressly operative for taxable years beginning on or after January 1, 2009:

- Provision 2: Credit for employers' expenses to provide health care to employees;
- Provision 3: Credit for qualified medical care professional;
- Provision 8: Deduction for uncompensated medical care for a taxpayer, spouse, or dependents;
- Provision 9: Exclusion from gross income for rollovers from Archer MSA;
- Provision 10: Deductions for contributions to HSAs in computing adjusted gross income (AGI); and
- Provision 11: Penalty for failure to file required reports related to contributions and distributions from HSAs.

The remaining provisions of this bill would be operative beginning on or after January 1, 2010:

- Provision 1: Credit for health insurance expenses for taxpayer and dependents;
- Provision 4: Credit for uncompensated medical care;
- Provision 5; Credit for a primary care provider;
- Provision 6: Conformity to federal HSA deductions for employer contributions;
- Provision 7: Conformity to federal HSA deductions for contributions to HSAs in a cafeteria plan;
- Provision 12: Refund offsets for providing services to uninsured persons.

## POSITION

Pending.

## SUMMARY OF SUGESTED AMENDMENTS

Technical amendments are necessary and are provided. Department personnel are available to work with the author to resolve any other issues that arise as the bill moves through the legislative process.

**Summary of Revenue Impact of SB 92  
 As Amended March 11, 2009  
 (\$ in Millions)**

Provision	2009/10	2010/11	2011/12
1. Credit for health insurance expenses for taxpayer and dependents	-\$4,000	-\$9,500	-\$10,000
2. Credit for employers' expenses to provide health care to employees	-\$400	-\$600	-\$700
3. Credit for qualified medical care professional	-\$75	-\$65	-\$65
4. Credit for uncompensated medical care	-\$130	-\$110	-\$120
5. Credit for a primary care provider	-\$5	-\$6	-\$8
6. Conformity to federal HSA deductions for employer contributions	-\$7	-\$7	-\$9
7. Conformity to federal HSA deductions for contributions to HSAs in a cafeteria plan	-\$130	-\$130	-\$150
8. Deduction for uncompensated medical care	\$-8	-\$21	-\$23
9. Exclusion from gross income of rollover amounts from Archer MSA	-\$0.6	-\$0.2	-\$0.07
10. Deductions For Contributions To HSAs	-\$45	-\$50	-\$60
11. Penalty for failure to file required reports	+\$1	+\$1	+\$1
12. Refund offsets for providing services to uninsured persons	No impact	No impact	No impact
<b>Total Impact</b>	<b>-\$4,800</b>	<b>\$10,488</b>	<b>-\$11,134</b>

**ANALYSIS**

Current Federal Law

*Health Savings Accounts*

Under federal law, individuals with a high deductible health plan (HDHP), and no other health plan other than a plan that provides certain permitted coverage, may establish a health savings account (HSA). In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents.

Within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual in determining adjusted gross income (AGI)<sup>1</sup> (i.e. "above-the-line"). Contributions to an HSA are excludable from income and employment taxes if made by the employer. Earnings on amounts in HSAs are not taxable. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 10 percent. The 10 percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

<sup>1</sup> AGI is defined by IRC section 62 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.

The maximum aggregate annual contribution that can be made to an HSA is the lesser of: (1) 100 percent of the annual deductible under the HDHP,<sup>2</sup> or (2) \$3,000 in the case of self-only coverage and \$5,950 in the case of family coverage.<sup>3</sup> Contributions in excess of the maximum contribution amount are generally subject to a 6 percent excise tax.

*Health flexible spending arrangements and health reimbursement arrangements*

Arrangements commonly used by employers to reimburse medical expenses of their employees (and their spouses and dependents) include health flexible spending arrangements (FSAs) and health reimbursement accounts (HRAs). FSAs typically are funded on a salary reduction basis, meaning that employees are given the option to reduce current compensation and instead have the compensation used to reimburse the employee for medical expenses. If the health FSA meets certain requirements, then the compensation that is foregone is not includible in gross income or wages and reimbursements for medical care from the health FSA are excludable from gross income and wages. Health FSAs are subject to the general requirements relating to cafeteria plans, including a requirement that a cafeteria plan generally may not provide deferred compensation. This requirement often is referred to as the “use-it-or-lose-it rule.”

HRAs operate in a manner similar to health FSAs, in that they are an employer-maintained arrangement that reimburses employees for medical expenses. Some of the rules applicable to HRAs and health FSAs are similar, e.g., the amounts in the arrangements can only be used to reimburse medical expenses and not for other purposes. Some of the rules are different. For example, HRAs cannot be funded on a salary reduction basis, and the use-it-or-lose-it rule does not apply. Thus, amounts remaining at the end of the year may be carried forward to be used to reimburse medical expenses in the next year. Reimbursements for insurance covering medical care expenses are allowable reimbursements under an HRA, but not under a health FSA. Subject to certain limited exceptions, health FSAs and HRAs constitute other coverage under the HSA rules.

Current California Law

California has not conformed to any of the federal HSA provisions. The California personal income tax return starts with federal 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.

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<sup>2</sup> The limits are indexed for inflation. For 2006, a high deductible plan is a health plan that has a deductible that is at least \$1,050 for self-only coverage or \$2,100 for family coverage and that has an out-of-pocket expense limit that is no more than \$5,250 in the case of self-only coverage and \$10,500 in the case of family coverage.

<sup>3</sup> These amounts are indexed for inflation. For 2009, a high deductible plan is a health plan that has a deductible that is at least \$1,150 for self-only coverage or \$2,300 for family coverage and that has an out-of-pocket expense limit that is no more than \$5,800 in the case of self-only and \$11,600 in the case of family coverage.

Although California has not conformed to HSAs, California law is conformed to the federal rules for Archer medical savings accounts (MSAs) and allows a deduction equal to the amount deducted on the federal return for the same taxable year. California imposes a 10 percent additional tax rather than the 15 percent additional federal tax on distributions from an MSA not used for qualified medical expenses.

Because a tax-free rollover from an MSA to an HSA is not allowed under California law, any distribution from an MSA that is rolled into an HSA must be added to AGI on the taxpayer's California return and as that MSA distribution is not treated as being made for qualified medical expenses it would, therefore, be subject to the MSA 10 percent additional tax.

Additionally, a federal tax-free qualified HSA funding distribution is not allowed under California law because California specifically does not conform to Internal Revenue Code (IRC) section 223, relating to HSAs, even though California conforms to IRC section 408, relating to IRAs.

Under California law, any distribution from an IRA to an HSA must be added to AGI on the taxpayer's California income tax return and would be subject to a 2 ½ percent additional tax under the rules for premature distributions under IRC section 72.

### *Cafeteria Plans*

Current federal law allows employers to extend certain benefits, including health care benefits, to employees without requiring inclusion of such benefits in the gross income of employees. For example, employees can exclude from gross income amounts received from an employer, directly or indirectly, as reimbursement for expenses for the medical care of the employee, the employee's spouse, and the employee's dependents. An employee also excludes from gross income the cost—that is, premiums paid—of employer-provided coverage under an accident or health plan. Insurance premiums paid for partners and more-than-2 percent S corporation shareholders are not excludable. Highly compensated individuals who benefit from an employer's "self-insured" medical reimbursement plan that discriminates in favor of "highly compensated employees," as those terms are defined, must include in income benefits not available to other participants in the plan.

Under IRC section 125, current federal law allows employers to offer a choice of benefits—assuming such benefits are otherwise excluded from gross income under a specific provision of the IRC—or cash to employees. A plan under IRC section 125 is also known as a "cafeteria plan." It is a written plan under which employee-participants may choose their own "menu" of benefits consisting of cash and "qualified benefits." No amount is included in the gross income of the employee-participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Employer contributions to a cafeteria plan can be made under a salary reduction agreement with the employee-participant if it relates to compensation that hasn't been received by, and does not become currently available to, the participant. A cafeteria plan can also include "flexible spending accounts" (FSAs) that are funded by employee contributions on a pre-tax salary reduction basis to provide coverage for specified expenses—such as qualified medical expenses or dependent care assistance—that are incurred during the coverage period and may be reimbursed.

IRC section 125 provides special rules with respect to plans that discriminate based on eligibility and benefits in favor of “highly compensated participants” and “key employees.” The practical benefit of cafeteria plans is that employees may make contributions in payment of benefits, such as insurance premiums, on a pre-tax basis. Such contributions reduce the amount of wages that would otherwise be subject to social security and Medicare taxes for both the employee and employer. Except for FICA withholding, California generally conforms to federal law in this area.

### *Credits Generally*

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who 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.

Current federal and state laws allow an itemized deduction for expenses paid during the taxable year that are not compensated by insurance or otherwise for the medical care of the taxpayer, the spouse of the taxpayer, or the dependents of the taxpayer to the extent that the expenses exceed 7.5 percent of the taxpayer's AGI.

### Limitation on Credits

For personal income tax (PIT) and corporate tax law (CTL) taxpayers for tax years beginning on January 1, 2008, and ending before January 1, 2010, the application of business credits as defined is limited to 50 percent of the net tax. Any amount of the credit that may not be allowed due to the 50 percent limitation may be carried over to subsequent tax years. Taxpayers with net business income of less than \$500,000 are excluded from these provisions.

### Assignment of Credits

For CTL, taxpayers that are members of a combined reporting group, eligible credits may be assigned by a taxpayer to an eligible assignee as defined. “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008. “Eligible assignee” means any “affiliated corporation” that is properly treated as a member of the same combined reporting group.<sup>4</sup> “Affiliated corporation” means a corporation that is a member of a commonly controlled group.<sup>5</sup> The election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.

### Interagency Intercept Program

Under state law, the State Controller is authorized to collect money that is due to one state agency by an individual by deducting the amount owed from credits due to such individual by another state agency. This procedure is called an interagency intercept.

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<sup>4</sup> Pursuant to Revenue and Taxation Code (R&TC) section 25101 or 25110.

<sup>5</sup> R&TC section 25105.

FTB operates the Interagency Intercept Collection program on behalf of the State Controller. Annually, FTB's intercept process receives requests from state agencies, local governments, and the IRS to intercept tax refunds or lottery winnings of individuals or business entities that owe delinquent amounts to those federal, state, and local agencies. Refunds are available for intercept after all existing tax debts have been satisfied. If there is more than one agency-offset request, the priority is as follows:

1. Delinquent child or family support cases enforced by a district attorney.
2. Delinquent child or family support cases enforced by someone other than a district attorney.
3. Delinquent spousal support cases enforced by a district attorney.
4. Delinquent spousal support cases enforced by someone other than a district attorney.
5. Unemployment benefits overpayment cases.
6. All other state agencies.
7. Cities and counties.
8. Private and post secondary education.
9. IRS.

#### THIS BILL

##### **Provision 1: Credit for health insurance expenses for taxpayer and dependents**

This provision would provide, for both personal income tax (PIT) and business entity (BE) taxpayers, for taxable years beginning on or after January 1, 2010, and before January 1, 2015, a credit against net tax as defined, in an amount equal to the amount paid or incurred by the taxpayer during the taxable year for qualified health expenses. The credit may not exceed any of the following for the taxable year:

- 7½ percent of the taxpayer's gross income,
- \$2,500 per each individual covered by the plan, or
- \$5,000 for all individuals covered by the plan.

This provision would define qualified health expenses to mean the total amount the taxpayer paid or incurred during the taxable year for health insurance and health care service plans for the taxpayer and his or her spouse and dependents. The provision would prohibit any other credit or deduction from being allowed for qualified health expenses for which this credit is taken. This credit would remain in effect until December 1, 2015, and as of that date would be repealed.

#### IMPLEMENTATION CONSIDERATIONS

This provision would provide a credit for business entities equal to the amount paid or incurred by the taxpayer during the taxable year for health insurance and health care service plans for the taxpayer and his or her spouse and dependents. A business entity does not have a spouse or dependents. It is recommended that this provision in the corporation tax code be removed in its entirety because it is unable to be applicable to business entities.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Credit For Health Insurance Expenses For Taxpayer And Dependents Enactment Assumed After June 30, 2009 Effective 1/1/2010 through 1/1/2015 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$4,000	-\$9,500	-\$10,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

The estimate of the number of individuals and families with health insurance is based on the distribution of California AGI by income groups for single and joint filers and on the percentage of each income group with insurance (from the California Health Care Foundation (CHCF) for 2007). Approximately 4 million individuals and 3 million families were estimated to have health insurance in 2006. The number of insured was estimated to grow at the state population growth rate of 1.2 percent. Based on CHCF data, the 2008 insurance premiums for single and family coverage were assumed to be \$582 and \$3,194, respectively. Based on the same source, these premiums were assumed to increase at 8 percent per year.<sup>6</sup> Limiting the amounts of credit to the amounts provided by the proposal and to taxpayers' taxable income, a total tax credit amount of \$8 billion for 2008 would result, \$1.5 billion for single filers and \$6.5 billion for joint filers. This amount is projected to grow to \$9.5 billion in 2010. Assuming a tax rate of 8 percent to calculate the amount of deductions under current law the deduction estimated for this credit would be approximately \$760 million resulting in a net-of-deduction amount of approximately \$8.8 billion (\$9.5 billion – \$760 million). The net-of-deduction revenue impact was projected to increase another 5 percent due to the incentive effect of the proposal. This results in a revenue impact of approximately \$9.2 billion for 2010 (\$8.8 × 1.05).

**Provision 2: Credit for employer's expenses to provide health care to employees**

For taxable years beginning on or after January 1, 2009, and before January 1, 2015, this provision would allow a credit to both PIT and corporate taxpayers in an amount equal to 15 percent of the amount paid or incurred by a qualified taxpayer during the taxable year for qualified health insurance for employees of the taxpayer who perform services in this state.

<sup>6</sup> California Health Care Foundation (CHCF) for 2007.

This provision would provide definitions for “qualified health insurance” to mean amounts paid on behalf of employees to an HDHP, as defined, or to an HSA, as defined. It would further define “qualified taxpayer” to mean any small or medium employer, or any small or medium employer that during the five taxable years immediately preceding the taxable year has not provided health insurance to employees employed by the employer in this state. Small employer would mean an employer that has at least 2, but no more than 50, employees; a medium employer would mean an employer with at least 51, but no more than 250, employees. If the credit allowed exceeds the net tax, the excess may be carried over to reduce the tax in the following year and succeeding years until the credit is exhausted.

The provision would provide that the credit would be in lieu of any deduction to which the taxpayer otherwise may be entitled for expenses on which a credit under the bill’s provisions is claimed.

The provision would require FTB to report to the Legislature on or before September 1, 2013, on the usage of this credit.

This credit would remain in effect until December 1, 2015, and as of that date would be repealed.

**IMPLEMENTATION CONSIDERATIONS**

This provision does not limit the number of years for the carryover period for this credit. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

The definition used for a qualified employer is a small or medium employer as defined, or a small or medium employer who has not provided health care coverage for five prior years. It is unclear why this distinction is being made because the provisions for this credit would apply to every small or medium employer.

**Revenue Estimates:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 <i>Credit For Employers Expenses To Provide Health Care To Employees</i> Enactment Assumed After June 30, 2009 Effective 1/1/2009 through 1/1/2015 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$400	-\$600	-\$700

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure. The numbers in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

This estimate assumes that employers offering new HDHPs in response to this bill's provisions would reduce wages paid by an amount equal to the amount that they contribute to the new health plans. Employers would then be allowed to claim a tax credit equal to 15 percent of that amount.

The remaining assumptions and parameters embodied in the estimates are based on state employment data, discussion with industry experts, and a survey of literature related to the California health care industry. Using the Employment Development Data (EDD) data, it is projected that approximately 6.6 million employees would be working in qualified taxable businesses in 2009. Based on the estimates by the CHCF, it is assumed that 30 percent (6.6 million x 30%), or approximately 2 million employees, would receive high-deductible insurance from their employers in 2009. Of this number, it is assumed that 70 percent or 1.4 million (2 million x 70%) buy insurance for themselves and 30 percent or 600,000 (2 million x 30%) include families.

The average premium for high-deductible health insurance is assumed to be \$2,500 for employees and \$6,000 for employees and dependents for the year 2009. A 7 percent annual growth rate is assumed for the premiums. Based on industry surveys, employers' share of the insurance costs was assumed to be 90 percent for employees and 75 percent for employees and dependents. Therefore, the total qualified employers' cost for 2009 was projected to be approximately \$5.8 billion calculated as follows:

Employees	$1.4 \text{ million} \times \$2,500 \times 90\% \approx \$3.1 \text{ billion}$
Employees and Dependents	$600,000 \times \$6,000 \times 75\% \approx \$2.7 \text{ billion}$
Total Employer Cost	approximately <u>\$5.8 billion</u>

An estimated 90 percent of this total amount is assumed to be apportioned to California. It is projected that only 60 percent of the apportioned amount would be deducted due to sufficient tax liability. Assuming a tax rate of 8 percent, this would result in an estimated \$250 million ( $\$5.8 \text{ billion} \times 90\% \times 60\% \times 8\% \approx \$250 \text{ million}$ ) of tax revenue impact under current law.

The estimate assumes that the number of employees covered by new health plans would be 5 percent higher than it would have been absent this new tax incentive. This would result in an additional insurance cost of approximately \$285 million incurred by the qualified employers for a total of \$6.1 billion ( $\$5.8 \text{ billion} + \$285 \text{ million}$ ). With a credit rate of 15 percent, the total credit amount was projected to be \$900 million for 2009 ( $\$6.1 \text{ billion} \times 15\%$ ). Sixty percent, approximately \$545 million ( $\$900 \text{ million} \times 60\%$ ), of this amount would be used due to sufficient income tax liability.

It is assumed that employers would reduce wages paid to their employees by an amount equal to the amount that they contribute to the new health plans. This would result in fewer deductions and an increase of income taxes of approximately \$250 million.

The net revenue impact of this provision for 2009 would be approximately \$295 million ( $\$545 \text{ million} - \$250 \text{ million}$ ). Unused credits would be carried over until used.

**Provision 3: Credit for qualified medical care professional**

For taxable years beginning on or after January 1, 2009, this provision would provide a tax credit in an amount equal to 25 percent of the net tax of an individual who is a qualified medical care professional. This provision would define “qualified medical care professional” to mean any individual licensed as a healing arts practitioner, as defined, who provides medical services in a rural area as defined.

The provision would provide that if the credit allowed exceeds the net tax, the excess may be carried over to reduce the net tax in the following year and succeeding years until the credit is exhausted.

**IMPLEMENTATION CONSIDERATIONS**

The term “qualified medical care professional” is defined using the term “healing arts practitioner.” “Healing arts professional” is used in the Business and Professional Code with a broad definition that could be interpreted to include veterinarians, social workers, registered dispensing opticians, hearing aid dispensers, acupuncturists, psychologists, lab technicians, and pharmacists. Additionally, the provision fails to define “medical services.” The lack of definitions for key terms can lead to disputes between the department and taxpayers. The author may wish to narrow the definition for “medical care professional” and provide a definition for “medical services” to ensure the intent is satisfied.

This provision lacks criterion for how long or to what extent the medical care professional must provide medical service in the rural area to qualify for the credit. The medical professional could qualify for the credit for a full tax year by providing service on the last day of the tax year, even if that service consisted of only being “on-call.” The author may wish to specify a minimum period during which the medical professional must provide medical services in the rural area to ensure that the credit is effective.

This provision does not limit the number of years for the carryover period for this credit. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Credit For Qualified Medical Care Professional Enactment Assumed After June 30, 2009 Effective For Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$75	-\$70	-\$70

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The amounts in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

EDD estimates the number of healthcare practitioners in California in 2006 and 2016 to be 650,300 and 795,700, respectively, implying an average annual growth rate of 2 percent. Applying this growth rate to the 2006 figure, it is projected that the number of healthcare practitioners in 2009 to be 690,883. According to the State of California Rural Health Policy Council, 8 percent of Californians live in rural areas. Applying this ratio to the total, it is estimated that the number of healthcare practitioners in rural areas in 2009 to be approximately 55,000 (690,883 X 8%).

According to the same EDD data, the median income of healthcare practitioners in 2006 was \$70,000. Assuming a growth rate of 5 percent, it is projected that this amount is approximately \$81,000 in 2009 [ $\$70,000 + (\$70,000 \times 5\% \times 3 \text{ years})$ ]. Data provided by the U.S. Department of Agriculture indicates that the 2006 ratio of the average earnings per job in California's rural areas to the overall average (rural plus urban) was approximately 63 percent. The average income of the healthcare practitioners in California rural areas is projected to be approximately \$51,000 ( $\$81,000 \times 63\%$ ).

With these assumptions, the total income earned by the healthcare practitioners in California's rural areas in 2009 is approximately \$2.8 billion ( $\$51,000 \times 55,000$ ). Assuming a tax rate of 8 percent the total tax liability would be approximately \$224 million for 2009 ( $\$2.8 \text{ billion} \times 8\%$ ). At a credit usage rate of 25%, the total amount of qualifying credits would be approximately \$56 million for 2009 ( $\$224 \text{ million} \times 25\%$ ). The numbers in the above table reflect cash flow estimates for fiscal years. For example, the amount for the 2009-10 fiscal year includes approximately \$18 million of 2010 liability estimate for a total of approximately \$75 million. Because the credit is a percentage of tax liability, no carryovers were assumed.

**Provision 4: Credit for uncompensated medical care**

This provision would allow a tax credit in an amount equal to 50 percent of the fair market value of uncompensated medical care provided by a physician during the taxable year to an eligible individual.

The provision would define "physician" to mean a physician or surgeon licensed by the Medical Board of California or Osteopathic Medical Board of California. The provision would define "eligible Individual" to mean a resident of this state who is not covered by health insurance and is a member of a household whose combined household AGI for the taxable year is less than 150 percent of the federal poverty level for that household for the applicable taxable year. The provision would define "fair market value of uncompensated medical care" to include only those medical procedures covered by Medicare or Medi-cal and would not exceed a specified reimbursement rate authorized under Medicare for any medical procedures for which a credit would be allowed.

The provision would provide that if the credit allowed exceeds the net tax, the excess could be carried over to reduce the net tax in the following year and succeeding years until that credit is exhausted.

**IMPLEMENTATION CONSIDERATIONS**

This provision would require that for this credit, an “eligible individual” is a member of a household whose combined household AGI for the taxable year is less than 150 percent of the federal poverty level for that household for the applicable taxable year. Generally, income information is confidential and, as such, it would be difficult for the physician to substantiate that an eligible individual meets the income requirement. The author may wish to specify how to substantiate such income and not compromise confidential information.

This provision would provide for a credit for uncompensated medical care provided to California residents, which could be considered discriminatory against nonresident taxpayers. It is recommended that the provision be revised to provide for uncompensated medical care performed in the state to prevent disputes with taxpayers.

This provision uses a term that is undefined, “uncompensated.” The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

This provision does not limit the number of years for the carryover period for this credit. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

**ECONOMIC IMPACT**

**Revenue Estimates:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Credit For Uncompensated Medical Care Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$130	-\$110	-\$120

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The amounts in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

## Revenue Discussion:

According to studies by healthcare economists, total revenue for physicians in the U.S. in 2004 was \$400 billion. The amount of uncompensated care was 1 percent of this amount, or \$4 billion. It is assumed that California's share of uncompensated care is 10 percent of the national amount and that 50 percent of this amount is spent on eligible individuals. This results in \$200 million of uncompensated care on eligible individuals ( $\$4 \text{ billion} \times 10\% \times 50\%$ ). With a credit usage rate of 50 percent, total qualifying credits would equal \$100 million ( $\$200 \text{ million} \times 50\%$ ). Assuming a 5 percent average annual increase in physicians' revenues, this amount would grow to approximately \$130 million in 2009. Under current law, it is assumed that 80 percent of this amount, or \$104 million ( $\$130 \text{ million} \times 80\%$ ), would be deducted by physicians with sufficient income tax liability. Assuming a tax rate of 8 percent would result in a tax effect of approximately \$8 million ( $\$104 \text{ million} \times 8\%$ ). The net-of-deduction revenue impact of the proposal would be approximately \$96 million ( $\$104 \text{ million} - \$8 \text{ million}$ ) for 2009. The numbers in the above table reflect cash flow estimates for fiscal years. For example, the amount for the 2009-10 fiscal year includes approximately \$34 million of 2010 liability estimate for a total of \$130 million.

### Provision 5: Credit for a primary care provider

This provision would allow a tax credit in an amount equal to 10 percent of the net tax for the taxable year for a primary care provider who provides primary care for patients in this state during the taxable year. The provision would define a primary care provider as a physician, surgeon, nurse practitioner, or physician's assistant. The credit would be limited to a primary care provider who first commences providing primary care services in this state on or after January 1, 2007.

The provision would provide that the credit would only be allowed for the first 10 taxable years for which the primary care provider provides primary care services in this state. For a primary care provider who is a physician or surgeon and changes his or her practice from primary care to specialty care, any credit previously allowed by this section must be recaptured by adding the amount of the credit to the net tax for the taxable year in which the change of practice occurs.

The provision would provide that if the credit exceeds the net tax the excess may be carried over to reduce the net tax in the following year and succeeding years until the credit is exhausted.

### IMPLEMENTATION CONSIDERATIONS

The term "primary care provider" is defined using broad terms such as physician and surgeon, a nurse practitioner, or a physician's assistant and is unclear whether the "primary care provider" should be licensed. In addition, the term "primary care services" remains undefined. The absence of definitions to clarify these terms could lead to disputes with taxpayers and complicate the administration of this credit. The author may wish to narrow the definition for "primary care provider" and provide a definition for "primary care services" to ensure the intent is satisfied.

This provision would allow the credit to be recaptured if a physician or surgeon changes his or her practice from primary care to specialty care. Also, a credit would be allowed for a primary care provider that commences primary care services on or after January 1, 2007, in this state. It is unclear how the department would determine the change of practice or commencement of services. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer.

This provision does not limit the number of years for the carryover period for this credit. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

**ECONOMIC IMPACT**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Credit For A Primary Care Provider Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$5	-\$6	-\$8

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

Based on an analysis of data obtained from the California Medical Board and California Health Care Foundation, it is estimated that approximately 400 primary care physicians (PCPs) and 1,000 nurses started their practice in 2007, 2008, and 2009. Based on this increase in PCPs and nurses that enter into the medical field, it is estimated that approximately 1,200 PCPs and 3,000 nurses would qualify for the credit in 2009. Beginning in 2010, the number of PCPs and nurses are projected to increase at 1 percent and 5 percent, respectively—average annual growth rates due to incentives provided by this provision. Each year the incomes of these professionals are projected to increase at 2 percent due to inflation and 3 percent due to additional experience, for total of 5 percent.

PCPs and nurses are assumed to earn \$150,000 and \$85,000 in 2009, respectively. These assumptions result in a total income of approximately \$435 million for 2009 [(1,200 × \$150,000) + (3,000 × \$85,000)]. Assuming a tax rate of 8 percent, a total tax liability of \$35 million (8% × \$435 million) would be expected, with the qualifying credits generated estimated to be \$3.5 million (\$435 million × 8% × 10% credit rate.).

To estimate the amount of the recapture for physicians that become specialists, it is assumed that it would take three years for a PCP to become a specialist (due to residency requirements) and that 10 percent of every year’s graduates would become a specialist. Therefore, for example, 10 percent of 2007 graduates would become specialists in 2010. Tax credits earned by these groups would be recaptured three years after they start their practice.

**Provision 6: Conformity to federal HSA deductions for employer contributions and Deductions for uncompensated medical care costs and contributions to HSA can be used to compute AGI**

This provision would provide that for PIT taxpayers deductions related to uncompensated medical care costs for the taxpayer, spouse, dependents, and in the case of a married couple, any dependents of each spouse, may be used in computing AGI...

The provision would provide that deductions related to contributions to HSAs could be used in computing AGI for taxable years beginning on or after January 1, 2009.

**IMPLEMENTATION CONSIDERATIONS**

Upon resolution of the Technical Considerations discussed below, implementing this provision of the bill would not significantly impact department programs and operations.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Conformity To Federal HSA Deductions For Employer Contributions Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$7	-\$7	-\$9

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

For the 2006 taxable year, tax return data for California residents indicates 28,000 returns reflected HSA adjustments on Schedule CA, which accounts for differences in federal and State AGI. This amount is 65 percent higher than the previous year. This estimate assumes a growth rate of 100 percent for 2007, 50 percent for 2008, and 25 percent for 2009 taxable years for the number of employees with HSA accounts. This would result in approximately 105,000 employees in 2009 with eligible HSA accounts.

Based on data published by the CHCF, it is assumed that 80 percent of the employees (approximately 84,000) have accounts for themselves and 20 percent (approximately 21,000) include family coverage. The CHCF data indicates that in 2008 the premium average for high-deduction insurance with savings options were approximately \$4,000 for singles and \$11,000 for a family. These figures exceed the limitation amounts mentioned above, therefore, the limitation amounts are used to estimate the deductions. Assuming that employers incur 25 percent of insurance costs for individual employees and their families, a total contribution amount of approximately \$71 million for 2009 is estimated  $[(84,000 \times \$2,250 \times 25\%) + (21,000 \times \$4,500 \times 25\%)]$ .

It is assumed that 80 percent of this amount, or approximately \$57 million, would be deducted due to sufficient taxable income. This amount is increased by 5 percent due to the incentive effect of the proposal. Applying a tax rate of 8 percent to the resulting amount of \$60 million results in a tax impact of approximately \$4.8 million for 2009 (\$57 million × 1.05 × 8% ≈ \$4.8 million).

**Provision 7: Conformity to federal HSA deductions for employer contributions and contributions to HSAs in a cafeteria plan**

This provision would provide that for taxable years beginning on or after January 1, 2009, a deduction would be allowed in conformity with certain sections of the IRC code as follows:

- Section 106 of the IRC relating to deductions for employer contributions to HSAs.
- Section 125 of the IRC relating to deductions for contributions to HSAs in a cafeteria plan.

**IMPLEMENTATION CONSIDERATION**

Upon resolution of the Technical Considerations discussed below, implementing this provision of the bill would not significantly impact department programs and operations.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Conformity To Federal HSA Deductions For Contributions To HSAs In A Cafeteria Plan Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$130	-\$130	-\$155

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

Based on EDD data, it is projected that California firms would employ approximately 17 million employees in 2009. It is estimated that 85 percent of these employees, or approximately 14 million, would work in taxable businesses. It is further assumed that 50 percent of these employees, or seven million, would be under a Section 125 cafeteria plan offered by their employers. It is assumed that 5 percent of these employees, or 350,000 (17 million × 85% × 50% × 5%), would have a health savings account.

The CHCF data indicates that the average premium for high-deduction insurance with savings options in 2008 was approximately \$4,300 for singles and \$12,000 for a family. Based on the CHCF data, it is assumed that 80 percent of the employees (approximately 283,000) would have accounts for themselves and 20 percent for families (about 72,000). Based on the same source it is assumed that employers pick up 90 percent of costs for individual employees and 75 percent for employees' families. These assumptions result in a total contribution amount of \$1,883 millions for 2009, calculated as follows:

Employees (approximately)	$283,000 \times \$4,300 \times 1.08 \text{ Growth Factor} \times 90\% \approx$	\$1,183 million
Employees' Families	$72,000 \times \$12,000 \times 1.08 \text{ Growth Factor} \times 75\% \approx$	<u>\$700 million</u>
Total		approximately <u>\$1,883 million</u>

It is assumed that only 60 percent of this amount, or approximately \$1.1 billion, would be claimed due to sufficient taxable income. This amount is increased by 5 percent due to the incentive effect of the proposal. Applying a tax rate of 8 percent, the tax impact of this provision is estimated to be approximately \$94 million for 2009 ( $\$1.1 \text{ billion} \times 1.05 \times 8\%$ ).

**Provision 8: Deduction for unreimbursed medical expenses**

This provision would provide that for PIT taxpayers, for taxable year beginning on or after January 1, 2010, and before January 1, 2015, a deduction would be allowed in an amount equal to the cost not compensated by insurance or otherwise paid or incurred during the taxable year by the taxpayer for medical care for the taxpayer, his or her spouse, his or her dependents, and in the case of a married couple, any dependents of each spouse. The deduction would not exceed any of the following for the taxable year:

- 7½ percent of the taxpayer's gross income,
- \$2,000 per person, or
- \$5,000 per family.

The provision would provide definitions for various terms used and the deduction allowed would be in lieu of any other deduction otherwise allowable for the costs for which the deduction is allowed.

This deduction would remain in effect until December 1, 2015, and as of that date is repealed.

**IMPLEMENTATION CONSIDERATIONS**

This provision uses a new stand alone definition for medical expenses, which may cause confusion for taxpayers because the definition for medical expenses already exists in the IRC. The author may want to use the definition for medical expenses from the IRC<sup>7</sup> for consistency in its application to income tax law.

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<sup>7</sup> IRC section 213

This provision uses a term that is undefined, "family." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this deduction.

**ECONOMIC IMPACT**

**Revenue Estimate**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Deduction For Unreimbursed Medical Expenses Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2010 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$8	-\$21	-\$23

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

Using the National Health Expenditure Survey, the Employee Benefit Research Institute (EBRI), and the California Health Care Foundation, the out-of-pocket medical expenses for 2010 are projected to be approximately \$35 billion. This figure includes such items as co-payments and co-insurances. Aggregate health insurance premiums are projected to be \$20 billion for 2010, resulting in total uncompensated expenses of \$55 billion (\$35 billion + \$20 billion). This estimate assumes that the contributions to health insurance by employees who have 125 plans are not deductible under this provision. Limiting the amount of deductions as specified by the provision reduces the amount of qualifying deductions to approximately \$275 million (.50% x \$55 billion). Based on data from California Health Care Foundation, a growth rate of 8.5 percent was assumed for this amount for the subsequent years. Assuming a tax rate of 8 percent, deductions for 2010 would be estimated at \$22 million (\$275 million x 8.5% x 8%). Based on tax return data, the amount of deductions for this group of taxpayers under current law is estimated to be approximately \$1 million resulting in a net revenue loss of \$21 million for 2010.

**Provision 9: Exclusion from gross income of rollover amounts from Archer Medical Savings Account**

This provision would provide that for PIT taxpayer taxable years beginning on or after January 1, 2009, the exclusion from gross income allowed under the IRC relating to rollovers from Archer Medical Savings Accounts would apply for purposes of state income tax treatment.

**IMPLEMENTATION CONSIDERATIONS**

Upon resolution of the Technical Consideration discussed below, implementing this provision would not significantly impact department programs and operations.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Exclusion From Gross Income Of Rollover Amounts From Archer Medical Savings Account Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$0.60	-\$0.20	-\$0.07

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

Based on data obtained for the 2002 taxable year (this is the last year for which reliable tax return data exists), taxpayers made deductible MSA contributions of \$15.5 million. For purposes of this estimate, it is assumed that contributions increase at a rate of 20 percent in 2003 and 2004 and that contributions decline by 15 percent per year after 2004 because of the availability of HSAs. The rate of decline increases to 20 percent after tax year 2007, which is the “cut-off year” for MSAs. To derive this estimate, it is also assumed that in each year 60 percent of the amount accumulated in MSA accounts would be withdrawn to pay for medical expenses. Based on these assumptions, the amounts in MSAs are projected to be approximately \$17 million in 2009. Although there is no requirement that balances in MSAs be rolled over, it is anticipated that rollovers would likely occur in the initial one or two years of conformity and that 40 percent of the funds remaining in the MSA accounts would be rolled over to HSA accounts in 2009 and 2010. The amount rolled over in 2009 would be approximately \$6.9 million (\$17 million × 40%). Applying a marginal tax rate of 8 percent results in revenue losses of \$.6 million for 2009 (\$6.9 million × 8%).

**Provision 10: Deductions for contributions for HSAs**

This provision would provide that for PIT taxpayer’s taxable years beginning on or after January 1, 2009, deductions allowed under the IRC relating to deductions for contributions to HSAs are allowed except as otherwise provided. The provision would revise references in the IRC relating to imposition of tax of unrelated business income of charitable organizations to refer to references in the Revenue and Taxation Code. The provision also would provide that the 10 percent additional tax on distributions not used for qualified medical expenses in the IRC to be revised to 2½ percent for state purposes.

**IMPLEMENTATION CONSIDERATIONS**

Upon resolution of the Technical Considerations discussed below, implementing this provision would not significantly impact department programs and operations.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Deductions for Contributions to HSAs Enactment Assumed After June 30, 2009 Effective For Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	-\$45	-\$50	-\$60

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The amounts in the table above have been adjusted to reflect cash flow estimates for fiscal years.

**Revenue Discussion:**

The revenue impact of this provision would be determined by the following:

- (1) The amount of contributions to health savings accounts deducted on tax returns,
- (2) The amount of contributions to health savings accounts made on behalf of employees (including salary reduction contributions),
- (3) The amount of balances in Archer medical savings accounts rolled over to health savings accounts, and
- (4) The marginal tax rates of taxpayers deducting or excluding such contributions.

For the 2006 taxable year, tax return data for California residents indicates 28,000 returns reflected HSA adjustments on Schedule CA totaling \$86 million. This means that these taxpayers made tax-deductible contributions for federal purposes that were reversed for state purposes. The amount reported on 2006 tax returns was 90 percent higher than those on 2005 returns. This estimate assumes a growth rate of 100 percent for 2007, 50 percent for 2008, and 25 percent for 2009 taxable years. For 2009, contributions by California individual taxpayers to HSAs are estimated at \$322 million, calculated as follows:

Amount Reported for 2006	\$86 million
Amount Projected for 2007 at 100% Growth Rate	\$ 86 million × 2 = \$172 million
Amount Projected for 2008 at 50% Growth Rate	\$172 million × 1.50 ≈ \$257 million
Amount Projected for 2009 at 25% Growth Rate	\$257 million × 1.25 ≈ <u>\$322 million</u>

Applying a marginal tax rate of 8 percent results in a revenue loss of approximately \$26 million (\$322 million x 8% ≈ \$26 million).

Contributions made by an employer on behalf of an employee (including salary reduction contributions made through a cafeteria plan), cannot be identified on a tax return. The number of additional HSAs that may exist as a result of this contribution arrangement is unknown. Data indicate that 6 percent of employers offer HSA-eligible HDHPs. It is assumed that most of these employers pay the premium for the HDHP rather than contribute to the employee's Health Savings Account. The rationale is that the premium is often less than the amount of the deductible that can be contributed to the HSA. Also, HSA balances are portable<sup>8</sup> and not owned by the employer. For purposes of this estimate, it is assumed that employer contributions on behalf of an employee are approximately one-quarter of that by individuals, or \$78 million in 2009 (\$310 million x 25% ≈ \$78 million). Applying a marginal tax rate of 8 percent results in an additional revenue loss of \$6.2 million for 2009 (\$78 million x 8% ≈ \$6.2 million). For 2009, the tax revenue impact of the provision is approximately \$32 million (\$26 million + \$6.2 million).

**Provision: 11 Penalty for failure to file required reports**

This provision would provide that for taxable years beginning on or after January 1 2009, if a person fails to file a report regarding an HSA contribution, distribution, or the return of excess contributions, in a time and manner prescribed by the Secretary of the Treasury, a penalty of \$50 would be imposed for each failure unless it is shown that the failure is due to reasonable cause.

**IMPLEMENTATION CONSIDERATIONS**

Implementing this provision would not significantly impact department programs or operations.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, the revenue impact of this provision is estimated to be as follows:

Revenue Impact of SB 92 Penalty For Failure To File Required Reports Enactment Assumed After June 30, 2009 Effective Taxable Years Beginning On or After 1/1/2009 (\$ in Millions)			
	2009-10	2011-12	2012-13
Revenue Impact	+\$1	+\$1	+\$1

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision. The numbers in the table above are net of deductions and have been adjusted to reflect cash flow estimates for fiscal years.

<sup>8</sup> "Portable accounts" means that the balances can be transferred with the employee if they leave their job.

**Revenue Discussion:**

Based on EDD data, it is projected that there would be approximately 1 million small firms (employing 1 to 199 employees) and 12,500 large firms (employing more than 199 employees) in 2009. According to CHCF, 40 percent of small employers (400,000) and 30 percent of large employers (3,750) offer high-deductible insurance to their employees. It is assumed that 50 percent of small firms (200,000) and 10 percent of large firms (375) would fail to file the report, for a total of 200,375 firms. This would result in a total penalty of approximately \$10 million ( $200,375 \times \$50$ ). It is assumed that 10 percent of this amount, or \$1 million, would be recovered in a subsequent audit.

**Provision 12: Refund offsets for providing services to uninsured persons**

This provision would provide that a hospital or health care provider may file a claim with the Department of Health Care Services (DHCS) to be reimbursed for health care services it has provided under the following requirements:

- The services were provided to an individual who was not covered by a health insurance policy or plan and was not eligible to receive health care benefits under a government program at the time he or she received health care services.
- The individual who received the services has not paid the hospital or health care provider for those services.
- The claim must be filed 90 days or more after the health care services were provided and include the following information on the claim:
  - The identity of the debtor, and
  - The amount owed to the claimant for health care services provided.

Upon receipt of the claim, the director of DHCS must determine whether the claim has merit, and if so determined, certify the debt to FTB and the California Lottery Commission (Lottery) to have the debt satisfied with any tax refund or lottery prize money owed to the debtor. The certification of the debt must include the identity of the debtor and the amount of money owed to the claimant. Once certified, the debt constitutes a debt owed to DHCS.

Upon receiving the certification, FTB and Lottery must determine if the debtor is owed tax refund or lottery prize money and is required to notify the debtor by certified mail of the following:

- The amount of money owed to the claimant for health care services.
- That the debtor's tax refund or lottery prize money will be reduced by the amount owed.
- The debtor's right to a fair hearing to object to FTB's or Lottery's actions.

The provision would provide that if the tax refund or lottery prize money is more than the debt owed, the debtor shall receive the remaining difference within a reasonable time after the excess amount is determined. The money deducted from the tax refund or lottery prize money would be prohibited from exceeding the sum of the amount owed to the claimant and any administrative costs incurred by DHCS, FTB or Lottery. Delinquent taxes owed by the debtor would be paid prior to offsetting amounts to satisfy the claim from DHCS.

The provision would provide that if a debtor disagrees with actions taken by FTB or Lottery, he or she shall have the right to receive a fair hearing from either the FTB or Lottery as appropriate.

The provision would require FTB to deduct the amount owed from the tax refund and transmit the funds to DHCS. Upon receipt of the funds, DHCS must settle the debt owed to the claimant. The provision would provide that DHCS may charge an administrative cost limited to no more than 20 percent of the collected amounts.

The provision would direct FTB, DHCS, and Lottery to jointly promulgate regulations necessary to administer the provisions related to the offsets of tax refunds and lottery prize winnings.

This provision would provide definitions for terms such as claimant, debtor, department, director, and health care provider.

### IMPLEMENTATION CONSIDERATIONS

This provision would require that FTB issue a notice by certified mail when a certified offset request from DHCS has been received. Generally, existing tax administration statutes do not require certified mail for notices to be legally effective. Because the majority of mail issued from the department is done through batch mailings to save expenses, sending this notice by certified mail would be labor intensive and costly for the department to comply with this requirement.

Under this provision, a debtor would be entitled to a fair hearing with the FTB. It is unclear what the substantive purpose of that hearing would be. FTB would have no information other than the identity of the debtor and the amount of debt to discuss or refute assertions made by a debtor in such a hearing. Similar to how nontax debt disputes are resolved, disputes from a debtor over the existence or amounts of the debt would need to be referred to DHCS (or the creditor agency) for resolution, which should also be the agency to conduct the fair hearing.

This provision would require that after payment of any tax amounts owed, any remaining refund amount be distributed to the DHCS claim. Under the existing refund offset process, priority for payment is statutorily established when a taxpayer has more than one offset request on file. It is unclear whether the author intends that priority to be disregarded for purposes of implementing this provision, or whether the author expects this debt to take its place in the priority list with other debts owed by the taxpayer.

Similarly, this provision provides that if the tax refund is more than the debt owed to DHCS, the taxpayer is to receive the difference within a reasonable time. It is unclear whether the author intends that other refund offset requests be satisfied before remitting the difference to the taxpayer, or whether the author intends to allow the taxpayer to circumvent payment of those other debts through the tax refund offset process. To implement a different refund offset process than what is currently in place would require significant revisions to existing computer programs and offset processes.

This provision would authorize DHCS to charge a fee up to 20 percent of the offset amount to cover expenses in administering the provisions of the bill. It is unclear whether DHCS will add that amount to the amount referred for offset or would deduct that amount from the amounts remitted from the offset. It is recommended the author specify how this fee is intended to be accounted for to prevent any disputes in the implementation of this bill's provisions. It is also unclear whether the 20 percent fee for processing includes the costs of FTB (or the Lottery Commission) or if FTB may charge its own additional processing amount and whether there are other limitations imposed on that processing amount.

This provision would provide specified information be provided to FTB as part of DHCS's certification. The certification would include "identity of the debtor", which is unspecified. It is recommended that the identity of the debtor include the social security number and address of the debtor to enable FTB to match the debtor with the correct tax record.

This provision would direct FTB or Lottery to transfer funds to DHCS. The current offset process provides that the State Controller's Office transfers the funds to the participating agencies. As written, this provision would require the development of a separate process for disbursements that is inconsistent with the existing processes for transfers of funds.

#### ECONOMIC IMPACT

This provision would not impact state income tax revenues.

#### TECHNICAL CONSIDERATIONS

In 2005, AB 115 (Stats. 2005, Ch. 691) changed the "specified date" of conformity to federal law from January 1, 2001, to January 1, 2005, for taxable years beginning on or after January 1, 2005. That act specifically did not conform to the federal HSA provisions by adding Revenue and Taxation Code sections 17131.4, 17131.5, 17215.1, and 17215.4 to explicitly provide for that nonconformity for taxable years beginning on or after January 1, 2005. If conformity to the federal HSA provisions contained in this bill are enacted and become operative for taxable years beginning on or after January 1, 2009, those sections providing explicit nonconformity should only apply to the 2005 through 2009 taxable years. The attached amendments would resolve this issue.

On page 109, line 23, after "gross," incomes" should be changed to "income".

On page 112, beginning with line 37, SEC. 55 provides for a credit for corporate qualified health insurance expenses that defines those expenses to mean the total amount the taxpayer paid or incurred during the taxable year for health insurance and health care service plans for the taxpayer and his or her spouse and dependents. This section should be deleted from the bill because corporations would not provide health insurance to itself nor does the corporation have a spouse or dependent.

## LEGISLATIVE HISTORY

AB 84 (Nakanishi, 2007/2008) would have allowed the same deduction on California personal income tax returns for contributions to an HSA as is allowed on the federal personal income tax return for the taxable year. This bill was held in the Assembly Revenue and Taxation Committee Suspense File.

AB 1040 (Duvall, 2007/2008) would have allowed a deduction for medical care expenses paid or incurred during the taxable year for medical care for the taxpayer, taxpayer's spouse, or the taxpayer's dependents. This bill was held in the Assembly Revenue and Taxation Committee Suspense File.

AB 1592 (Huff, et al., 2007/2008) would have allowed a credit for uncompensated medical care provided by physicians. AB 1592 failed to pass out of the Assembly Revenue and Taxation Committee.

SB 820 (Ashburn, 2007/2008) would have established a credit against franchise and income tax in the amount of 15 percent of administrative costs associated with establishing or administering a "cafeteria plan." The bill was held in the Senate Revenue and Taxation Committee.

SB 1026 (Calderon, 2007/2008) would have provided an income tax credit for a "qualified health care provider" in an amount equal to the amount paid or incurred during a taxable year to provide health care to residents of the state whose health care is not covered by a health care service plan or health insurance. This bill was held in the Senate Health Committee.

SBX1 8 (Aanestad, 2007/2008) would have allowed a tax credit to physicians who provide uncompensated medical care. This bill was double referred to the Committees on Health and Revenue and Taxation; no further action was taken.

SBX1 20 (Runner, 2007/2008) would have provided a personal income tax credit for primary care providers in California. This bill was double referred to the Committees on Health and Revenue and Taxation; no further action was taken.

SBX1 21 (Cogdill, 2007/2008) would have provided a tax credit for a medical care professional that provides medical care in a rural area. This bill failed passage in the Senate Health Committee.

SBX1 23 (Ashburn, 2007/08) would have allowed a credit against corporation tax and PIT for administrative costs associated with establishing or administering a "cafeteria plan." This bill failed passage out of the Senate Revenue and Taxation Committee.

## FISCAL IMPACT

The department's costs to administer this bill cannot be determined until the implementation concerns discussed above have been resolved.

## **POLICY CONSIDERATION**

Claimants under the refund offset provisions of this bill would be essentially private creditors for whom a privileged exception to ordinary civil processes is being granted by allowing access to the offset process for state income tax refunds. Placing these debts equal to or superior in priority than that of child support debts or debts owed to other governmental agencies is a departure from existing policy.

The credit provisions for this bill are lacking a repeal date. Generally, repeal dates for credits are recommended so that the Legislature has the opportunity to determine whether the credit is accomplishing its objective, and whether the benefit supports the cost in terms of tax expenditures and policy objectives.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 92  
As Amended March 11, 2009

AMENDMENT 1

On page 109, line 29, after "SEC. 49." insert:

Section 17131.4 of the Revenue and Taxation Code is amended to read:  
17131.4. (a) Section 106(d) of the Internal Revenue Code, relating to contributions to health savings accounts, shall not apply.

(b) This section shall cease to apply to taxable years beginning on or after January 1, 2009, and is repealed as of December 1, 2009.

SEC. 50. Section 17134.5 of the Revenue and Taxation Code is amended to read:

17131.5. (a) Section 125(d)(2)(D) of the Internal Revenue Code, relating to the exception for health savings accounts, shall not apply.

(b) This section shall cease to apply to taxable years beginning on or after January 1, 2009, and is repealed as of December 1, 2009.

SEC 51

AMENDMENT 2

On page 109, line 38, after "SEC.", ~~strikeout "50"~~ and insert:

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AMENDMENT 3

On page 110, line 8, after "SEC.", ~~strikeout "51"~~ and insert:

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AMENDMENT 4

On page 110, line 34, after "SEC.", ~~strikeout "52"~~ and insert:

54

AMENDMENT 5

On page 111, line 16, after "SEC." , strikeout "53 " and insert:

55. Section 17215.1 of the Revenue and Taxation Code is amended to read:  
17215.1. (a) Section 220(f)(5) of the Internal Revenue Code, relating to rollover contributions, shall not apply.

(b) This section shall cease to apply to taxable years beginning on or after January 1, 2009, and is repealed as of December 1, 2009.

SEC. 56. Section 17215.4 of the Revenue and Taxation Code is amended to read:

17215.4. (a) Section 223 of the Internal Revenue Code, relating to health savings accounts, shall not apply.

(b) This section shall cease to apply to taxable years beginning on or after January 1, 2009, and is repealed as of December 1, 2009.

SEC. 57.

AMENDMENT 6

On page 112, line 37, after "SEC." , strikeout "55 " and insert "58 " , and renumber the remaining sections accordingly.