Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Morrell & Gaines Analyst: David Scott Bill Number: AB 726

Related Bills: Telephone: 845-5806 Amended Date: May 2, 2011

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Exclusion/Payments Or Distributions From Retirement Account Paid Into Health Savings Accounts/Waive Early Distribution Penalty

SUMMARY

This bill would exclude from gross income amounts paid or distributed from a taxpayer's 401K account to a Health Savings Account (HSA) and waive the 2½ percent early withdrawal penalty, if the amount paid or distributed does not exceed $100,000.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The May 2, 2011, amendments resolved the department's technical consideration by accepting the amendment suggested in the department's analysis dated March 30, 2011. The May 2, 2011 amendments also added a limitation on the amount excluded from gross income, which addressed one of the Franchise Tax Board's policy concerns. The limitation added results in a small change to the Revenue Estimate. Revised "This Bill" section, Technical Considerations, Revenue Estimate, and the Policy Concerns, are included below. The "Implementation Considerations" are restated for convenience. The balance of the department's analysis of the bill as introduced February 17, 2011, still applies.

ANALYSIS

THIS BILL

This bill would allow distributions or payments, not to exceed $100,000, made from a taxpayer's 401K plan to an HSA to be excluded from gross income for state income tax purposes. In addition, those distributions or payments that would normally be subject to a 2 ½ percent penalty under state law would not be subject to the penalty. This bill excludes the amount of the distribution from gross income, but only if the amount received does not exceed $100,000 and the taxpayer deposits the full amount of the distribution into an HSA within 60 days of receipt. The exclusion would not apply to a transfer from the 401K account to an HSA by a direct trustee-to-trustee transfer.

Board Position:			Legislative Director	Date
_____ S	_____ NA	__X__ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	05/27/11
_____ N	_____ OUA			

IMPLEMENTATION CONSIDERATIONS

The department identified the following implementation concerns in its analysis of the bill as introduced on February 17, 2011 and are restated here for convenience. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- California does not conform to federal HSA rules. The bill does not provide a definition for an HSA. As a result, any account labeled as an HSA, whether or not it meets the federal requirements of an HSA, could be considered an HSA described in this bill. The absence of definitions to clarify what an HSA is could lead to disputes with taxpayers and would complicate the administration of this exclusion from gross income. If the author's intent is to follow the federal definition, the bill should be amended with cross-referencing to the applicable federal provisions.
- The language of the bill would allow a payment or distribution to "a health saving account." The distribution or payment could go to someone else's HSA, other than the taxpayer's. If this is not the author's intent, it is recommended that the bill be amended.
- The bill would allow the exclusion from gross income, but only if the full amount that was distributed does not exceed $100,000 and is contributed to an HSA. For a non-qualified lump sum distribution from a 401K, there may be withholding of federal income tax and possibly state income taxes, depending on how the 401K account distributions are set up. Any taxpayer receiving a distribution will not get the full amount in hand and will need to add an amount to offset the federal tax withheld.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 726 For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed After June 30, 2011 ($ in Millions)		
2011-12	2012-13	2013-14
-$2.2	-$1.5	-$1.5

POLICY CONCERNS

Although a number of bills have been introduced to conform to federal HSA rules, the legislature has not adopted legislation conforming to those rules. As a result, California does not recognize HSAs as tax-favored vehicles for providing for healthcare costs. This bill would create an additional difference between the federal and state tax treatment of HSAs and distributions from 401K plans.

This bill would limit the exclusion to only distributions from a 401K account. There are other types of accounts that are within the definition of "eligible retirement account." Owners of the other types of accounts (e.g. IRA accounts) could view this as unfair treatment. A distribution from an IRA account to an HSA would result in the taxpayer being assessed a 2½ percent additional tax, on top of the distribution being included in gross income, whereas, if the distribution is made from a 401K, there would be no tax assessed. The result is two different treatments for the same type of transaction. Additionally, federal law does not provide a waiver of the ten percent penalty for a withdrawal from a 401K plan to fund an HSA. Allowing the penalty waiver for state purposes is in conflict with federal tax policy.

Federal law allows a one-time distribution from an individual retirement plan (other than simplified employee pension plan or a simple retirement account) to an HSA. In addition, federal law does not allow a distribution from a 401K to HSAs, unless the taxpayer has reached age 59 1/2. Consequently, the provisions of this bill appear at odds with federal HSA and 401K policy.

LEGISLATIVE STAFF CONTACT

David Scott
Legislative Analyst ,FTB
(916) 845-5806
david.scott@ftb.ca.gov

Brian Putler
Legislative Director, FTB
(916) 845-6333
brian.putler@ftb.ca.gov