Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Conway	Analyst:	David Scott	Bill Number:	AB 1018
Related Bills:	None	Telephone:	845-5806	Amended Date:	March 21, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Exclusion/Specified Amount Paid for Unreimbursed Qualified Medical Expenses

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), provide individuals an unspecified exclusion from gross income for qualified medical expenses.

RECOMMENDATION

No position.

Summary of Amendments

The March 21, 2013, amendments removed provisions of the bill related to the Health and Safety Code, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department's programs and operations.

REASON FOR THE BILL

The reason for this bill is to provide some relief to California personal income taxpayers for ever increasing medical costs, in light of higher federal thresholds for deducting those medical costs.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2013.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

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Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations. These are items that the taxpayer has received as economic benefits, but have been specifically excluded by law.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions[1]. Also, itemized deductions may be further limited for high-income taxpayers.

Federal Law

In 2010, Federal tax law increased the threshold for the itemized deduction for unreimbursed medical expenses from 7.5 percent of adjusted gross income (AGI) to 10 percent of AGI for regular income tax purposes. However, for the years 2013 through 2016 inclusive, if either the taxpayer or the taxpayer's spouse turns 65 before the end of the taxable year, the increased threshold does not apply and the threshold remains at 7.5 percent of AGI.

State Law

California conforms to Internal Revenue Code (IRC) section 213, relating to the itemized deduction for unreimbursed medical expenses in excess of 7.5 percent of AGI, as of the specified date of January 1, 2009.

Because the 2010 federal change discussed above was enacted after the specified date, the California threshold amount for deducting unreimbursed medical expenses for regular tax remains at 7.5 percent of AGI.

THIS BILL

For taxable years beginning on or after January 1, 2013, this bill would do the following;

- Provide an exclusion from gross income for an unspecified amount of qualified expenses.
- Define “qualified expenses” to mean expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, the taxpayer’s spouse or registered domestic partner, or a dependent, for any of the following:
    - Medical care, as defined by Section 213 of the IRC, relating to medical, dental, etc., expenses;
    - Preventative care, as that term is used in Section 223(c)(2)(C) of the IRC, relating to high deductible health plan; or
    - Care provided for an elderly dependent within the taxpayer’s home or at a day facility.
- Allow a deduction for the qualified expenses, in addition to the exclusion, otherwise allowed under the PITL.

[1] Only the portion that exceeds 2% of adjusted gross income may be deducted.

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.

The bill would allow an unspecified amount as an exclusion from gross income for qualified expenses, as defined. Without specifying these amounts, the department would be unable to implement this bill. The department would also be unable to determine any economic impact until the amount is specified. It is recommended that the author amend the bill and specify the amount to be excluded.

The bill defines "preventative care" by reference to IRC section 223(c)(2)(C), which has an error in its reference to Section 1871 of the Social Security Act. Section 1871 does not define "preventive care." That section discusses "Regulations." As a result, the bill currently lacks a definition of "preventive care." IRC section 213, which is used to define "medical care" in the bill, includes "for the diagnosis, cure, mitigation, treatment, or prevention of disease[2], or for the purpose of affecting any structure or function of the body." As a result a definition of "preventive care" may not be necessary. As an alternative, if a definition of "preventive care" is preferred, a possibility would be to amend the definition of "preventive care" so that it has the same meaning as "preventive services" in Section 1861 of the Social Security Act (42 USC sec. 1395x) as amended by P.L. 108-173. The author may wish to amend the bill to resolve this issue.

TECHNICAL CONSIDERATIONS

This bill would provide an exclusion from gross income for an unspecified amount of medical expenses. The bill calls the amount an exclusion. Exclusions are items that would otherwise be included in gross income, except they have been specifically excluded from gross income by law. Medical expenses (except reimbursements for medical expenses) can't be an exclusion because an exclusion must first be an item of income. AB 1018 is trying to create a deduction from gross income or perhaps allowing the taxpayer to exclude from their other income an amount equal to their medical expenses. This is really a deduction, rather than an exclusion. The author may wish to amend the bill to resolve this technical consideration.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Massachusetts allows an exemption amount equal to the amount of medical expenses paid if the taxpayer files married joint on their federal and *Massachusetts* income tax returns and they have itemized on their federal return.

Florida, Illinois, Michigan, Minnesota, and *New York* laws do not provide a similar exclusion comparable to the exclusion this bill would allow.

[2] Emphasis added.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Until the implementation concerns have been resolved, the FTB is unable to determine the revenue impact of this bill.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would provide much needed relief for California's citizens that must manage increasing medical costs.

Opponents: Some may argue that additional tax expenditures should be avoided during California's fragile economic recovery.

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