

Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Ting Analyst: Scott McFarlane Bill Number: AB 362
 Related Bills: See Legislative History Telephone: 845-6075 Introduced Date: February 14, 2013
 Amended Date: April 2, 2013
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Reimbursements for Federal Taxes Imposed on Employer-Provided Health Benefits of Same-Sex Spouses and Domestic Partners

SUMMARY

This bill would provide an exclusion from gross income for reimbursements employers provide to employees who have same-sex spouses and domestic partners.

RECOMMENDATION

No position.

Summary of Amendments

As introduced on February 14, 2013, this was a spot bill. The April 2, 2013, amendments would provide an exclusion from gross income of reimbursements employers pay to employees who have same-sex spouses and domestic partners to offset federal taxes imposed on their employer-provided health benefits, as discussed in this analysis.

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

REASON FOR THE BILL

The reason for the bill is to provide tax relief to same-sex spouses and domestic partners who, unlike opposite-sex spouses, pay federal taxes on employer-provided health benefits provided to their spouses, partners, and the dependents of their spouses and partners.

EFFECTIVE/OPERATIVE DATE

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

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BACKGROUND

Employer-provided health benefits are generally excludible from gross income for employees, their spouses, and their dependents. However, because federal law does not recognize same-sex spouses and domestic partners as spouses for tax purposes, employees may exclude from gross income only the employer-provided health benefits of themselves and their dependents, and are taxed on the health benefits employers provide for their same-sex spouses, domestic partners, and dependents of those spouses and partners. California law treats same-sex spouses and domestic partners as spouses for tax purposes, and as a result does not tax employer-provided health benefits provided to employees, their dependents, their same-sex spouses, domestic partners, and dependents of those spouses or partners.

Some employers are providing reimbursements to their employees who have same-sex spouses or domestic partners to offset the federal tax that is imposed on their families' employer-provided health benefits. Those reimbursements are taxable under federal and state law.¹

ANALYSIS

FEDERAL/STATE LAW

Federal Law

Exclusion for Employer-Provided Health Coverage

Federal law generally provides that employees are not taxed on (that is, may "exclude" from gross income) the value of employer-provided health coverage under an accident or health plan.² This exclusion applies to coverage for personal injuries or sickness for employees (including retirees), their spouses and their dependents. In addition, any reimbursements under an accident or health plan for medical care expenses of employees (including retirees), their spouses, their dependents,³ and any of their children⁴ who, as of the end of the taxable year, have not attained age 27, generally are excluded from gross income.⁵

Employers may agree to reimburse medical expenses of their employees (and their spouses and dependents), not covered by a health insurance plan, through flexible spending arrangements that allow reimbursement not in excess of a specified dollar amount (either elected by an employee under a cafeteria plan or otherwise specified by the employer). Reimbursements under these arrangements are also excludable from gross income as employer-provided health

¹ Some employers are "grossing up" (i.e., increasing) the amount of those reimbursements to offset the income taxes imposed on the reimbursements. The total amounts of such reimbursements, including any "grossed-up" amounts that are included, are taxable under federal and state law.

² IRC section 106.

³ As defined in IRC section 152, without regard to whether or not a taxpayer is a dependent of another taxpayer (IRC section 152(b)(1)), whether an individual is married (IRC section 152(b)(2)), or whether or not an individual's gross income is less than the federal exemption amount (IRC section 152(d)(1)(B)).

⁴ As defined in IRC section 152(f)(1).

⁵ IRC section 105(b).

coverage. The same definition of dependents applies for purposes of flexible spending arrangements.

The exclusion from gross income for employer-provided health care specifically does not apply to health benefits employers provide to an employee's same-sex spouse or domestic partner, or to the dependents of that spouse or partner, under Section 3 of the Defense of Marriage Act.⁶ That Act amended federal law to provide that in the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.

Gross Income

Gross income is the starting point in determining an individual's taxable income. Gross income is broadly defined, and generally consists of all income from all sources, such as compensation for services, business income, interest, rents, dividends, and gains from the sale of property.⁷ Only items that are specifically exempt may be excluded from gross income; thus, any reimbursements employers provide to employees who have same-sex spouses and domestic partners to offset the federal tax imposed on their employer-provided health benefits are includible in gross income.

State Law

Exclusion for Employer-Provided Health Coverage

California law generally conforms to the federal rules relating to the gross-income exclusion for employer provided health benefits.⁸ However, California law provides that same-sex spouses and domestic partners are treated as the spouse of the taxpayer for purposes of determining various tax benefits, including employer-provided health benefits.⁹ Thus, unlike federal law, employer-provided health benefits provided to employees' same-sex spouses, domestic partners, and dependents of those spouses or partners, are excludible from gross income.

Gross Income

California law generally conforms to the federal rules that determine gross income;¹⁰ thus, similar to federal law, any reimbursements employers provide to employees who have same-sex spouses and domestic partners to offset the federal tax imposed on their employer-provided health benefits are includible in gross income.

⁶ Public Law 104-199. Section 3 of DOMA has been found unconstitutional in eight federal courts; the U.S. Supreme Court has heard an appeal in one of those cases, *United States v. Windsor*, with oral arguments on March 27, 2013, and an opinion is expected to be announced within the next few months.

⁷ IRC section 61.

⁸ R&TC section 17131.

⁹ R&TC section 17021.7.

¹⁰ R&TC section 17071.

THIS BILL

This bill would exclude from gross income any amounts received by an employee from an employer to reimburse federal income taxes that are paid by the employee on health-care benefits because, for federal income tax purposes, the same-sex spouse or domestic partner of the employee is not considered the spouse of the employee, including any reimbursement of federal income taxes paid with respect to those amounts.¹¹

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

SB 1827 (Migden, Chapter 802, Statutes of 2006) requires registered domestic partners (RDPs) to file personal income tax returns using the same rules applicable to married couples. In addition, this bill eliminated a provision that made a distinction between earned and unearned income of an RDP for purposes of applying community property rules for state income tax purposes.

AB 205 (Goldberg, Chapter 421, Statutes of 2003) gave RDPs the same rights, such as community property rights, and obligations that are granted to and imposed upon spouses in a civil marriage, with some exceptions. It also added language that required the same filing status on a state income tax return that is used on a federal income tax return and provided that earned income is not community property for state income tax purposes.

AB 25 (Migden, Chapter 893, Statutes of 2001) allowed several existing taxpayer benefits for medical expenses and health insurance benefits to be made available to a taxpayer's domestic partner as the taxpayer's spouse.

AB 26 (Migden, Chapter 588, Statutes of 1999) allowed the establishment of domestic partnerships for couples meeting specified conditions.

OTHER STATES' INFORMATION

The states surveyed for tax treatment employer-provided health benefits for same-sex spouses and domestic partners 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.

A review of these states' laws found that *Illinois* excludes from gross income employer-provided health benefits provided to employees, partners of employees in same-sex civil unions, and to the dependents of those partners, but does not exclude from gross income any reimbursement of federal income taxes paid with respect to those benefits.

¹¹ The exclusion from gross income would also apply to any amount of the reimbursement that represents the "grossed-up" amount that an employer includes to offset income taxes imposed on the health-care reimbursement.

Massachusetts and New York exclude from gross income employer-provided health benefits provided to employees, their same-sex spouses and dependents of those spouses, but do not exclude from gross income any reimbursement of federal income taxes paid with respect to those benefits.

Michigan and Minnesota exclude from gross income employer-provided health benefits for employees, but do not exclude from gross income employer-provided health benefits for their same-sex spouses or domestic partners, or dependents of those spouses and partners, and do not exclude from gross from gross income any reimbursement of federal income taxes paid with respect to those benefits.

Florida does not impose personal income tax, thus no one pays income tax on their employer-provided health benefits or any reimbursement of federal income taxes paid with respect to benefits provided for their same-sex spouses, domestic partners, or dependents.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 362 As Amended April 2, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
- \$1.8	- \$1.2	- \$1.3

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill is necessary to alleviate the inequity of the tax treatment of employer-provided health benefits of same-sex spouses and domestic partners.

Opponents: Some may argue that employees should include in gross income any additional remuneration that their employers choose to pay them.

LEGISLATIVE STAFF CONTACT

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