

BILL ANALYSIS

Department, Board, Or Commission	Authors	Bill Number
Franchise Tax Board	Ting & Gordon	AB 362

SUBJECT

Compensation 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 health-care compensation employers provide to employees who have same-sex spouses and domestic partners.

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 upon enactment and operative for taxable years beginning on or after January 1, 2013. The exclusion would be repealed on January 1, 2019.

BACKGROUND

Employer-provided health benefits are generally excludible from gross income for employees, their spouses, and their dependents. However, prior to the recent June 26, 2013, U.S. Supreme Court decision that invalidated a key part of the 1996 Defense of Marriage Act (DOMA), federal law did not recognize same-sex spouses and domestic partners as spouses for tax purposes, which meant that employees could exclude from gross income only the employer-provided health benefits of themselves, their opposite-sex spouses, and their dependents, and were taxed on the health benefits employers provided for same-sex spouses, domestic partners, and dependents of those spouses and partners.

As a result of the U.S. Supreme Court's DOMA decision, legally married same-sex spouses will be treated as spouses for federal tax purposes, but same-sex domestic partners will not. Thus, employees who have legally married same-sex spouses will no longer be taxed on the health benefits employers provide for their spouses and dependents of those spouses, while employees who have same-sex domestic partners will continue to be taxed on the health benefits employers provide for their partners and dependents of those partners.

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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 and partners.

Some employers are providing reimbursements to their employees who have same-sex spouses or domestic partners to offset the federal tax that is or was imposed on their families' employer-provided health benefits. Those reimbursements are taxable compensation under federal and state law,¹ regardless of whether or not employees receive such reimbursements before or after the DOMA decision.

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 coverage. The same definitions of spouses and dependents apply for purposes of flexible spending arrangements.

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).

On September 21, 1996, Section 3 of the Defense of Marriage Act (DOMA) provided that the exclusion from gross income for employer-provided health care specifically did 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.⁶ DOMA 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" meant only a legal union between one man and one woman as husband and wife, and the word "spouse" referred only to a person of the opposite sex who is a husband or a wife.

On June 26, 2013, Section 3 of DOMA was found to be unconstitutional by the U.S. Supreme Court.⁷ As a result, on August 29, 2013, the U.S. Department of the Treasury and the IRS ruled that same-sex couples who are legally married in jurisdictions that recognize their marriages will be treated as spouses for federal tax purposes. That decision does not change the federal tax treatment of same-sex domestic partners, who will continue to be treated as unmarried for federal tax purposes.

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.⁸ 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, and the fact that Section 3 of DOMA was found to be unconstitutional does not change the taxability of any such reimbursements.⁹

In other words, although legally married same-sex spouses will no longer be taxed on the value of their spouses employer-provided health benefits, thus eliminating the federal tax for which employers were providing reimbursements, to the extent any reimbursements were made prior to the U. S. Supreme Court's decision, or that continue to be made to legally married same-sex spouses during this transition period, those reimbursements are included in gross income. And, any such reimbursements that employers made, or may continue to make, to same-sex domestic partners, are included in gross income as compensation.

⁶ Public Law 104-199.

⁷ *Windsor v. United States* (2013) 570 U.S. ___ [133 S. Ct. 2884, 2013 U.S. Lexis 4935].

⁸ IRC section 61.

⁹ Although the July 26, 2013, decision by the U.S. Supreme Court resulted in married same-sex couples being treated as married for federal tax purposes, it does not change the taxability of 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; that is, any such reimbursements that individuals receive prior to, on, or after the July 26, 2013, decision, are still 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.¹⁰ However, California law provides that same-sex spouses and registered domestic partners are treated as the spouse of the taxpayer for purposes of determining various tax benefits, including employer-provided health benefits.¹¹ Thus, unlike federal law, employer-provided health benefits provided to employees' same-sex spouses, registered 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;¹² thus, similar to federal law, any reimbursements employers provide to employees who have same-sex spouses and registered domestic partners to offset the federal tax imposed on their employer-provided health benefits are includible in gross income as compensation.

THIS BILL

This bill would exclude from gross income any reimbursements received by an employee from an employer to compensate for additional federal income taxes that are incurred by the employee on employer-provided health-care benefits because, for federal income tax purposes, the employee's same-sex spouse or domestic partner is not (or was not) considered the employee's spouse. The exclusion from gross income would also apply to any amount of the employer-provided health-care compensation paid to an employee that represents the "grossed-up" amount that an employer includes to offset additional federal income taxes incurred on such compensation.

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.

¹⁰ R&TC section 17131.

¹¹ R&TC section 17021.7 provides specific rules for registered domestic partners. For additional information, see FTB Publication 776, Tax Information for Same-Sex Married Couples.

¹² R&TC section 17071.

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.

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 state income tax on their employer-provided health benefits.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 362* Assumed Enactment After June 30, 2013		
2013-14	2014-15	2015-16
- \$50,000	- \$30,000	- \$40,000
* Although no changes have been made to the bill since it was amended on May 21, 2013, the revenue loss has been reduced from the FTB's prior estimate of the bill as amended on that date because the U.S. Supreme Court's June 26, 2013, DOMA decision results in legally married same-sex individuals being treated as spouses for federal tax purposes, thus reducing the universe of taxpayers that would be impacted by this bill.		

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

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: Equality California (Sponsor); Alice B. Toklas Democratic Club; Facebook; Los Angeles Gay & Lesbian Center; Harvey Milk Democratic Club; California Nurses Association; City of Los Angeles; Orange County LGBTQ Center; Microsoft; San Francisco Mayor Edwin M. Lee; San Francisco Chamber of Commerce; City of Sacramento; Health Access; City of West Hollywood; California Association of Health Underwriters; and the AFSCME.¹³

Opposition: Unknown.

VOTES

Assembly Floor 05/28/13 Y: 56 N: 19
 Senate Floor 09/09/13 Y: 32 N: 4

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¹³ Senate Governance and Finance Committee Bill Analysis, August 8, 2013.