Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Kaloogian | Analyst: Garnier | Bill Number: AB 130

Related Bills: See Leg. History | Telephone: 845-5322 | Introduced Date: 01/06/99

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Health Insurance Deduction/Individuals/100% of Amount Paid

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow all individuals to deduct from gross income up to 100% of the cost of health insurance, up to the sum of the earned income of the taxpayer and taxpayer's spouse.

EFFECTIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

SB 305, SB 1991, AB 2107, AB 2131 (1997/98)

SPECIFIC FINDINGS

Existing federal law provides for a deduction in determining adjusted gross income (AGI) of 60% (effective for 1999) of a self-employed individual's cost for health insurance. Federal law also allows the deductible percentage to increase incrementally to 100% beginning in the year 2003. The percentage is increased as follows:

1999 through 2001	60%
2002	70%
2003 and thereafter	100%

Prior to the enactment of the **federal Tax and Trade Relief Extension Act of 1998,** (TTREA) the federal deductible percentage incrementally increased from 45% in 1998 to 100% in 2007.

California law provides for 40% of the cost of a self-employed individual's cost for health insurance to be deductible in determining AGI.

Under both federal and state law, "health insurance costs" include premiums paid for health insurance of the taxpayer, taxpayer's spouse and dependents. Certain qualified "long term care premiums" are also considered health insurance.

Additionally, **under both** federal and state law, a deduction for health insurance for self-employed individuals is not allowed from gross income if the individual or individual's spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual's spouse.

Board Position:			Department Director	Date
______ S	______ NA	______ NP		
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______ N	______ OUA	X PENDING	**Gerald Goldberg**	**2/19/99**

The deduction from gross income is limited to the extent of the individual's federal earned income from the business from which the health coverage was established.

Finally, **under both** federal and state law, the cost of health insurance incurred by a self-employed individual that is not deductible in determining AGI may be taken as an itemized medical deduction. Itemized medical deductions are limited to the amount that exceeds 7.5% of the taxpayer's AGI. All individuals may deduct health insurance costs paid by the individual, which are not excluded from income, as an itemized medical deduction subject to the 7.5% AGI floor.

This bill would extend the deduction from gross income for the cost of health insurance to all individuals, with modifications. This bill accomplishes the extension of the deduction by applying to all individuals the Internal Revenue Code section that permits the self-employed deduction. This methodology applies all the definitions, requirements and limitations, where applicable or not modified in this bill, used in the self-employed health insurance deduction to the health insurance deduction available for all individuals.

This bill also would increase the percentage of health insurance deductible by self-employed individuals from the 1999 level of 40% to 100% in 2007, as follows:

45% in 1998 and 1999,
50% in 2000 and 2001,
60% in 2002,
80% in 2003 through 2005,
90% in 2006, and
100% in 2007 and thereafter.

These phase-in amounts follow the federal phase-in amounts prior to the 1998 federal changes (i.e., the phase-in amounts added by the federal Taxpayer Relief Act of 1997). The author's staff has indicated that the bill will be amended to reflect the accelerated 1998 phase-in amounts.

The bill also allows the deduction even if the taxpayer or the taxpayer's spouse is eligible to participate in an employer-subsidized health plan and expands the self-employed earned income limitation to all earned income.

FISCAL IMPACT

Departmental Costs

The provisions of the bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Impact Effective 1/1/99 Enacted after 6/30/99 $ Millions							
1999-0	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
($180)	($175)	($200)	($280)	($385)	($415)	($460)	($560)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

The revenue impact of this provision will be determined by the number of individuals who pay any portion of their health insurance premiums, the cost of premiums, and the average marginal tax rate applicable to the deduction amounts.

This estimate was developed in the following steps. First, according to the 1996 U.S. Statistical Abstract, total national health insurance premium payments by households was $70.6 billion for 1994. Second, this number was grown 7% per year to yield $99 billion for 1999. Third, it is estimated that California represents 12% of the national amounts, generating approximately $12 billion in qualified insurance premium payments. Fourth, this number was reduced by 20% to account for the earned income requirement, leaving approximately $10 billion in qualified insurance payments. Fifth, the amount of current deductions taken under the PITL by taxpayers (i.e. households including self-employed) was calculated to be approximately $1.2 billion for 1999, representing around $53 million in tax reductions for 1999 under current law. Sixth, the total deduction was calculated at the proposed 45% at a 4.5% marginal tax rate for 1999, generating a $192 million tax loss. These steps resulted in a 1999 estimate of an additional $139 million tax loss. The 1999-0 fiscal year estimate consists of the 1999 tax loss ($139 million) and 25% of the 2000 impact ($172 million), reflecting reduced estimated tax/withholding payments. Seventh, the total deduction was then calculated at various percentages from 45% phasing up to 100% by the year 2007. Losses were grown to reflect a 7% increase in premiums based on current historical averages.

BOARD POSITION

Pending.