SCS Agency
Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Briggs	Analyst:	Kristina North	Bill Number:	AB 1667
Related Bills:	See Legislative History	Telephone:	845-6978	Amended Date:	April 29, 1999
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Dependent Health Care Coverage Credit/1999 Employer Health Care Coverage Incentive Act

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _______________________.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ___________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a 100% credit to employers to provide health care coverage to the dependents of eligible employees who meet the Healthy Families Program eligibility criteria.

This bill would require the Managed Risk Medical Insurance Board to assist the Legislature in developing an employer tax credit in lieu of or in addition to the purchasing credit mechanism.

This analysis discusses those issues pertaining to the Franchise Tax Board (FTB).

SUMMARY OF AMENDMENT

The April 29, 1999, amendment replaced an expression of legislative intent with the tax credit discussed in this analysis.

EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 2000.

BACKGROUND

Under the California Insurance Code, the Healthy Families Program provides access to health coverage to all children residing in households with family incomes below 200% of the federal poverty level. To participate in the Healthy Families Program, an individual must be over 18 and a natural or adoptive parent, legal guardian, or caretaker relative, foster parent, or stepparent with whom the child, for whom coverage is sought, resides. An individual 18 years old may

Board Position:			Department Director	Date
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apply for coverage on his or her own behalf. A child is eligible for coverage if the child is older than 1 year but less than 19 years old; is not eligible for no-cost, full-scope Medi-Cal or Medicare; is not covered by employer-sponsored insurance; meets federal citizenship and immigration status requirements applicable to participating in the federal program; and is a California resident in a family with a gross annual household income equal to or less than 200% of the federal poverty level.

An applicant must pay the first month's family contribution and agree to remain in the program for six months, unless other coverage is obtained and proof of the coverage provided, and must enroll all of his or her eligible children in the program. Family contribution amounts consist of two components: 1) flat fees from $4 to $9 per child with a maximum required contribution of $27 per month per family (based on annual household income to the federal poverty level and geographic area); and 2) any amounts charged to the program by participating health, dental, and vision plans selected by the applicant that exceed the cost to the program of the highest cost Family Value Package in a given geographic area. Applicants paying three consecutive months in advance receive the fourth month for free.

SPECIFIC FINDINGS

Current federal and state laws generally require all income from whatever source derived to be included in gross income for tax purposes. Gross income includes compensation for services such as wages. However, federal and state laws generally allow employer contributions to a health insurance plan to be excluded from the employee's income and deducted by the employer as a business expense.

Current federal and state laws allow a tax deduction for personal medical and dental expenses to the extent they exceed 7.5% of the taxpayer's adjusted gross income (AGI).

Current federal and state laws provide for various tax credits designed to provide tax relief for taxpayers who incur certain expenses or to influence business practices and decisions. However, neither state nor federal law currently allows a credit for costs paid or incurred for health care insurance for dependents of eligible employees who meet Health Families Program eligibility criteria.

Current federal and state tax laws define "dependent" as a son or daughter of the taxpayer, or a descendant of either; a stepson or stepdaughter of the taxpayer; a brother, sister, stepbrother, or stepsister of the taxpayer; the father or mother of the taxpayer, or ancestor of either; a son or daughter of a brother or sister of the taxpayer; a brother or sister of the father or mother of the taxpayer; a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer; or an individual (not a spouse) who lives with and is a member of the taxpayer's household during the taxable year.

This bill would allow a credit equal to 100% of the costs paid or incurred by an eligible employer, not currently providing dependent coverage, to provide health coverage to the dependents of eligible employees who meet Health Families Program eligibility criteria pursuant to provisions of the Insurance Code.
This bill defines:

- "eligible employer" as a taxpayer that employs employees and that makes the minimum contribution required by this section on behalf of the employee.

- "eligible employee" as an individual paid for performing services for an eligible employer for an average of at least 17.5 hours per week.

- "health coverage" as health coverage meeting the requirements of the Healthy Families benefits package as defined in the Insurance Code to guarantee that the benefits, copayments, coinsurance, and deductibles are no less than 95% actuarially equal to those provided to Health Families Program subscribers enrolled in the purchasing pool.

- "dependent" as an employee's minor children or stepchildren or other dependent who would qualify as an employee's dependent for the purposes of the PITL, except a spouse, who is under 19 and eligible for the Healthy Families Program.

This bill states that any employer expenditure under this provision would not be included in the employee's income for state tax purposes. If the employer expenditures are included in the employee's federal taxable income, these amounts would be deductible for state income tax purposes.

This bill requires the Franchise Tax Board to adopt regulations necessary to carry out the purposes of this section.

This bill requires that federal funding received pursuant to Title 21 of the United States Code (USC) be deposited to the General Fund to replace any state revenues used to provide this credit.

This bill provides unlimited carryover on any portion of the credit exceeding the taxpayer's tax liability and specifies that any carryover amount "be applied first to the earliest taxable (or income) years possible."

Policy Considerations

This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, if a repeal date were added and the unlimited credit carryover allowed, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

Implementation Considerations

The department has identified the following implementation considerations:

- This bill would limit the amount of credit allowed to not exceed the amount that would be spent in the Healthy Families Program for each qualified dependent. It is unclear what amounts the author intends to include in this computation. For the department to effectively implement this credit, clarification is needed for the phrase "not to exceed the amount spent in the Healthy Families Program."

- The credit would be allowed only to employers who are not "currently providing" dependent coverage. If the bill is enacted during 1999 but first effective for the 2000 year, it is unclear what date would be used to determine whether the employer is currently providing coverage. Furthermore, it is unclear whether this determination would be made only once, or whether it would be made each taxable or income year. For example, if a taxpayer stopped providing such coverage and subsequently resumed providing coverage otherwise qualifying for this credit, it is unclear whether that taxpayer would satisfy the "not currently providing" standard.

- The intent of the phrase “coverage at least equal to that provided under the Healthy Families Program for eligible employees who elect to have dependent coverage" is unclear and could lead to disputes between taxpayers and the department as to its meaning.

- This bill defines dependent as minor children or stepchildren of an employee or "**any other person** who qualifies as a dependent of the employee for the purposes of the [PITL] except a spouse." The PITL definition contains several other "dependents" which would not qualify under the Healthy Families Program and specifically excludes a spouse. Further, to qualify for the Healthy Families Program, a child must be under 19 years old in a family with a gross annual income of under 200% of the federal poverty level. This definition of "dependent" is different from the common definition used throughout tax law and may cause confusion. To clarify the stated intent, the author may wish instead to define "qualifying child" as meeting the requirements for participation in the Healthy Families Program.

- This bill provides that any expenditure by an employer for this health coverage is not income to the employee. In addition, the bill requires that those amounts included in determining federal taxable income for the employee be subtracted in determining an employee's state taxable income. It is unclear whether the author intends the amount as an above-the-line deduction or as an itemized deduction in determining taxable income. To avoid confusion, it would be better to provide that gross income shall not include the amounts expended pursuant to this section.

- Under the credit provision, this bill states that federal funding received pursuant to Title 21 of the United States Code must be deposited to the General Fund to replace any state revenues used to implement this bill. The FTB does not receive nor have the authority to deposit moneys received by other state agencies as federal funding into the General Fund. This section would be more appropriate in another code section, such as the Insurance Code where the Healthy Families Program is described.

Department staff is available to assist the author's office in resolving these and any other concerns identified.

Technical Considerations

It is unclear whether regulations would be necessary to implement this bill. The author may wish to consider changing "shall" to "may" so the department would not be required to adopt unnecessary regulations through the time-consuming regulatory process. Moreover, the "shall" requirement might be interpreted to require affirmative departmental action to adopt implementing regulations as a prerequisite to the credit becoming operative.

This bill provides credit carryover language; however, it does not specify that the credit may be carried over to reduce the net tax in future years until the credit is exhausted. The author may wish to modify this section to specify that the credit may be carried over into subsequent years to "reduce" the net tax.

The bill further seems to specify a priority rule with respect to credit carryovers, since it states that "[t]he credit shall be applied first to the earliest taxable years possible." This may conflict with the normal credit ordering rules specified under the PITL and B&CTL. Clarification of the author's intent on this issue would help avoid disputes between taxpayers and the department with respect to utilization of credit carryovers.

This bill refers to Title 21 of the U.S.C., however, Title 21 of the U.S.C. deals with food and drugs. The Healthy Families Program references Title 21 of the Social Security Act.

REGULATIONS

The FTB would be required to adopt regulations "necessary to carry out the purposes of" this act.

FISCAL IMPACT

Departmental Costs

With the resolution of the implementation considerations, this bill should not significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses in the initial years.

Estimated Revenue Impact of AB 1667 As Amended April 29, 1999 [$ In Millions]			
1999/2000	2000/2001	2001/2002	2002/2003
-$2	-$25	-$50	-$70

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

Tax Revenue Discussion

The number of dependent children (as defined and limited by the bill), costs incurred by eligible employers to provide health insurance for these children, and the amount of credits that could be applied to reduce tax liabilities of eligible employers would determine the revenue impact of this bill.

The estimate was derived in the following steps: (1) reduced the number of uninsured children meeting Healthy Families Program (HFP) eligibility criteria to a number of family units; (2) assumed two-thirds of working parents of these family units are employed by employers with a tax liability each year and one-third are employed by employers without a tax liability ; (3) projected percentages of employers that would offer qualifying health coverage; (4) estimated an average monthly premium of $125 per family unit for qualifying health coverage; (5) progressively phased in rates of participation by employers offering qualifying health coverage; (6) assumed rates at which credits would be applied to reduce tax liabilities; and 7) assumed that, as any fringe benefit, any expense claimed by the employer for this credit would not be taxable if included in an employee's federal income so nothing would be subtracted from the employee's state taxable income. (The average monthly premium of $125 was calculated by averaging the premium rate differential between a two-party premium and a family premium for a dozen different health carriers offering employer-sponsored health plans and adding an average monthly dental plan premium.)

According to a recent report, The State of Health Insurance in California, 1998, that analyzes trends in Californians' access to health insurance, an estimated 259,000 to 397,000 uninsured children are eligible for the HFP. (The mid-point, 328,000, is used for purposes of developing a revenue estimate for this bill.) Staff at the Managed Risk Medical Insurance Board indicated that families that have registered for HFP have an average of 1.8 children. Dividing the number of uninsured, eligible children by 1.8 suggests the number of family units is on the order of 182,225. Two-thirds of uninsured children eligible for the HFP have at least one parent who is a full-time employee, and virtually none is in a nonworking family. Employers of these working parents either do not currently offer health benefits or health benefits are limited to employees only.

It is assumed that by 2002, 50% of taxable employers and only 5% of nontaxable employers would offer qualifying health coverage. Reaching projected levels of employer participation would require a period of three years. (To offer health coverage to eligible dependents, it is assumed that employers also would offer coverage to the employee.) Multiplying the number of family units obtaining qualifying health coverage by an average monthly premium per family unit of $125 derived premium costs totaling nearly $100 million at maximum levels of projected employer participation. For taxable employers, it is assumed two-thirds of credits generated are applied to reduce tax liabilities in the year generated. For nontaxable employers, none would be applied in the year generated. Any carryover credits are assumed applied over a five-year period.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1667
As Amended April 29, 1999

AMENDMENT 1

On page 5, delete lines 11 through 16 and insert:

In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in succeeding taxable years, until the credit is exhausted.