Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Pacheco | Analyst: Kristina E. North | Bill Number: AB 2533

Related Bills: None | Telephone: 845-6978 | Introduced Date: February 24, 2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Prescription Drug Deduction

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a deduction in computing adjusted gross income (AGI) equal to the cost paid or incurred during the taxable year by a taxpayer for prescription drugs.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Current state and federal laws allow taxpayers a variety of deductions when calculating their tax liability. For individual taxpayers, some deductions are specifically allowed as a deduction from gross income in computing AGI. To determine taxable income, individual taxpayers reduce AGI by deducting either the applicable standard deduction or their itemized deductions.

Current federal law, to which **state law** conforms, specifically allows a deduction for unreimbursed medical care expenses, including costs for prescription drugs or insulin, as an itemized deduction, but only to the extent that the expenses exceed 7.5% of the taxpayer’s AGI. "Prescribed drug" is defined as a drug or biological that requires a prescription of a physician for its use by an individual.

This bill would allow an unlimited deduction in computing adjusted gross income for 100% of costs paid or incurred for prescription drugs.

Policy Considerations

This bill would create a state/federal difference in computing adjusted gross income by allowing a deduction for the costs paid or incurred by a taxpayer for prescription drugs as an "above the line" deduction, while federal law would continue to treat prescription drug costs as a "below the line" deduction.

Implementation Considerations

The implementation of this bill would not significantly impact this department.

Board Position:			Department Director	Date
_____ S	_____ NA	_____ NP	Alan Hunter for GHG	4/3/00
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_____ N	_____ OUA	__X__ PENDING		

Technical Considerations

Because this bill would provide a modification to the calculation of adjusted gross income, as conformed, it needs to be added to PITL section 17072. Amendment 2 is provided.

Because PITL Section 17201 specifies that "the Internal Revenue Code shall apply unless otherwise provided," this bill's "notwithstanding" language for that section in this bill is unnecessary and should be removed to avoid confusion. Amendment 1 is provided.

FISCAL IMPACT

Departmental Costs

This bill would 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.

Estimated Revenue Impact of AB 2533 As Introduced 2/24/2000 [$ In Millions]		
2000/2001	2001/2002	2002/2003
-$36	-$40	-$46

The bill would be effective with taxable years beginning on or after January 1, 2000, with enactment assumed after June 30.

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

Tax Revenue Discussion

The amount of deductible prescription drug costs and the marginal tax rates of taxpayers with deductible costs would determine the revenue impact of this bill.

Estimating the average annual out-of-pocket expenditure for prescription drugs and projecting the number of taxpayers that would incur and report such costs derived deductible prescription drug costs. Applying an average marginal tax rate of 6.5% and making an allowance for some small portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold) derived liability year revenue losses.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs was project at approximately $245 for 2000. From sample tax return data (1997 base), the number of taxable returns in 2000 was projected at approximately 8.8 million.

Assuming one-third of taxpayers (with tax liabilities) would incur the average out-of-pocket expenditure for prescription drugs and that, in the initial year, three-quarters of these taxpayers report eligible costs for purposes of the proposed deduction (nearly 2.2 million), deductible costs would be $530 million in 2000.

Applying an average marginal tax rate of 6.5% and deducting offsetting revenue gains (since the proposed deduction is in place of the present law deduction) derived a liability year loss of $33 million in 2000. Losses would grow each year due to inflating prescription drug costs, increasing number of taxable returns, and an increasing number of taxpayers reporting eligible costs for purposes of the deduction.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2533
As Introduced February 24, 2000

AMENDMENT 1

On page 1, line 1, after "SECTION 1." insert:

Section 17072 of the Revenue and Taxation Code is amended to read:
17072. (a) Section 62 of the Internal Revenue Code, relating to adjusted gross income defined, shall apply, except as otherwise provided.

(b) The amendments to Section 62 of the Internal Revenue Code, made by Section 13213 of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to modifications to deduction for moving expenses, shall apply to taxable years beginning on or after January 1, 1996.

(c) The deduction allowed by Section 17204, relating to interest on education loans, shall be allowed in computing adjusted gross income.

(d) The deduction allowed by Section 17205, relating to prescription drugs, shall be allowed as a deduction in computing adjusted gross income.

SEC. 2

AMENDMENT 2

On page 1, strikeout line 3 and insert:

17205. Notwithstanding Section 17201,