Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Knox	Analyst:	Gloria McConnell	Bill Number:	AB 2765
Related Bills:	See Legislative History	Telephone:	845-4336	Amended Date:	05/04/00
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Health Care Credit/FTB Report to the Legislature

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would provide eligible employers a credit for amounts paid or incurred to provide health coverage for eligible employees and their dependent(s). An eligible employee would include an individual employed part-time, in California, and who earns $20 per hour or less (or its equivalent).

The Franchise Tax Board (FTB) would be required to make an annual report to the Legislature and the Legislative Analyst on the number and costs of the tax credit claimed pursuant to this bill.

SUMMARY OF AMENDMENT

The May 4, 2000, amendments make numerous clarifying changes.

The April 25, 2000, amendments limit the definition of an eligible employee to those working part-time (an average of at least 16 hours, but less than 35 hours per week).

The April 3, 2000, amendments deleted the provisions that would have provided a credit relating to peak commute hours and added this employer-paid health coverage credit.

EFFECTIVE DATE

This bill, as a tax levy, would be effective immediately upon enactment. However, it would be expressly operative for taxable and income years beginning on or after January 1, 2001, and before January 1, 2008.

LEGISLATIVE HISTORY

AB 1262 (1999/2000), which proposed an Employer Provided Health Care Coverage Credit, failed passage due to missing the deadline for passing out of the house of origin. AB 1172 (1999), AB 2520 (1998), and AB 148 (1997) each proposed an Employer Provided Health Care Credit for Farmworkers, and each failed passage in policy committee.

AB 1734 (2000) proposes a similar employer provided health care credit. However, the AB 1734 credit is refundable, an eligible employer would be limited to those with no more than 25 full-time employees, and an eligible individual's salary would be limited to no more than three times the minimum wage.

Board Position:			Department Director	Date
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PROGRAM HISTORY/BACKGROUND

In 1988 (SB 2260; Stats. 1988, Ch. 1521) a credit was enacted for small employers (employers with the equivalent of no more than 25 "full-time" employees) that provided health coverage for their employees. However, the legislation was not operative until January 1, 1990. The operative date was delayed repeatedly (SB 107 (Stats. 1991, Ch. 103) and SB 617 (Stats. 1992, Ch. 699)) until the credit ultimately was repealed before it became operative (Stats. 1993, Ch. 74 and 75).

That earlier credit would have been the sum of:

(1) $25 per month per eligible individual, or 25% per month of the total amount paid or incurred for the health coverage, whichever was more, plus

(2) for each dependent of an eligible individual, $25 per month or 25% of the total paid or incurred for health coverage, whichever was more.

(3) an additional $5 tax credit per month per eligible individual for each of the two supplemental benefits, as defined.

To qualify for that earlier credit under SB 2260, the small employer would have had to have:

(1) paid or incurred at least 75% of the monthly health coverage premium for the insured, for which the individual did not pay more than 25%, and

(2) made participation available within 60 days of employment to all eligible individuals, which could have included part-time or seasonal employees if the employer elected to cover such individuals.

SPECIFIC FINDINGS

Under federal tax law, to which California conforms, an employer's contribution to an accident or health plan for the benefit of the employee, employee's spouse or dependents is not includable in the employee's gross income.

Existing federal and state tax laws allow ordinary and necessary business expenses to be deducted, which would include health care coverage premiums paid for employee accident or health plans.

Existing state tax law specifies the division of a credit between employers who share in the expenses that provide the basis for the credit.

Existing state and federal tax laws provide various tax credits that are designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Exiting state and federal tax laws provide a detailed definition for "dependent." In general, the first test is that the taxpayer must provide for over half of the support for that individual. Secondly, there is a specific relationship test. In general, a taxpayer's spouse is not that taxpayer's dependent.

Existing federal and state laws do not provide credits for any health care costs.

This bill would provide a credit for amounts paid or incurred during the taxable or income year by an eligible employer to provide health coverage for an eligible individual or his/her dependent(s). An eligible individual would have to be employed in California at least 16 hours but less than 35 hours per week and at a salary that does not exceed $20 per hour or its equivalent. An eligible employer must employ during the year no more than 50 employees, as defined. Participation must be made available to all eligible individuals. Finally, the bill specifies an anti-abuse rule that would prohibit an employer from reorganizing its business in any manner to circumvent the 50-employee limitation.

The allowed credit would be the sum of:

(1) $75 per month per eligible individual or 25% of the total amount paid or incurred per month for that health coverage, whichever is more, plus

(2) $75 per month or 25% of the total amount paid or incurred per month for health coverage for the covered individual's dependent or dependents, whichever is more.

To qualify for this credit the employer must pay or incur at least 80% of the monthly health coverage premium for the eligible individual or dependent(s), for which the individual does not pay more than 20%.

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

This bill specifies that any excess credit that exceeds the taxpayer's tax liability may be carried over to subsequent years until exhausted.

This bill specifies the division of credit between employers that share in the expenses and among partners in a partnership.

This bill, additionally, would require:

?? Specified governmental agencies to furnish annually, or more frequently upon request, the FTB with lists of licensed health care service plans and insurers authorized to transact disability insurance in California.

?? The FTB to make an annual report to the Legislature and the Legislative Analyst on the number and costs of the tax credit claimed pursuant to this bill.

Policy Consideration

?? Under this bill, the credit of $75 per month for each dependent could exceed what the employer actually pays for a family health coverage plan. For example, an eligible employer would be entitled to a credit that is the greater of: $75 per month per the covered individual's dependent or dependents, or 25% of the costs paid or incurred per month per the covered individual's dependent or dependents. If a family health coverage plan for a family of eight costs $500 per month, of which the employer pays 80%, the cost to the employer per month would be $400 ($500

X 80% = $400). However, the employer's monthly tax credit for providing that family plan would be $600 ($75 X 8 = $600).

?? Using the tax law definition of "dependent" for health coverage purposes may have a lesser incentive effect than the author intends. For example, covering a spouse of an eligible individual would not qualify the employer for this credit as a spouse is not a taxpayer's "dependent" under the tax law definition. Additionally, a child of a noncustodial parent may not be that parent's "dependent" under the tax law definition, yet that parent may be providing health coverage for that child.

Implementation Considerations

With resolution of the following implementation consideration, the provisions of this bill could be administered without significant difficulties.

Under the bill, the credit for the dependent coverage is allowed with respect to a "covered" individual's dependent or dependents (page 2, line 34 and page 7, line 15). "Covered individual" is undefined, but is assumed to refer to individuals provided with health coverage. This should be clarified in the bill. In addition, it is unclear whether the health coverage must be provided by the eligible employer and whether the "covered" individual must also be an eligible individual.

In subdivisions (g), for efficiency purposes, the list of plans and insurers should be available to FTB only "upon request," rather than "at least annually or more frequently, upon request." See Amendment 7.

Technical Considerations

The following technical considerations have been identified:

1. In subdivisions (b) of the bill as amended, references to "subdivision (g)" should be changed to subdivisions (f) consistent with the relettering of the subdivisions. Reference to "subparagraph (A)" should be deleted consistent with the elimination of subparagraph (A) in the bill as amended. See Amendment 1 and 2.

2. In paragraphs (1) of subdivisions (f), the phrase "average number of eligible individuals" should be revised to "number of employees" for consistency in that the determination of an "eligible employer" is based on the number of "employees," not the number of "eligible individuals." In addition, this paragraph should be amended to make it clear that the year that is being measured for purposes of determining an "eligible employer" is the calendar year immediately preceding the "beginning of the" employer's taxable year. See Amendments 3, 4, and 5.

3. In paragraphs (2) of subdivisions (f), the services should be limited to those performed "in California" to be consistent with the requirement that the "eligible individual" be employed in California. See Amendment 6.

LEGISLATIVELY MANDATED REPORTS

The FTB would be required to make an annual report to the Legislature and the Legislative Analyst on the number and costs of the tax credit claimed pursuant to this bill. The Legislative Analyst would be required to report to the Legislature by December 1, 2007, on the effectiveness of the tax credits.

FISCAL IMPACT

Departmental Costs

This bill would not significantly increase FTB's departmental costs.

Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows in applied credits:

Revenue Impact of AB 2765 Beginning 1/1/2001 **(In Millions)**			
	2000-1	2001-2	2002-3
Revenue Impact	($14)	($59)	($99)

As with other analyses for health insurance tax credits, it is assumed that in cases where the business has unitary affiliates firm size would be based on total employees for the combined group. This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

Using Employment Development Department data, it was estimated that about 50% of employees working in firms with no more than 50 employees earned hourly wages of $20 or less. Using the same data source, the percentage of part-time employees was projected to be about 20%. Using data from the U.S. Small Business Administration, it was estimated that about 25% of less than full-time employees had health insurance coverage for whom employers incurred at least 75% of the cost. The cost of health insurance ($304 per family per month) was obtained from a study conducted by the University of California. It was assumed that employers on average would incur 85% of the costs. An employer incentive effect due to the credit was allowed starting at around 5% and reaching 15% after three years. It was further assumed that 80% of the credits could be used in the current year with the remaining carried over to succeeding years.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2765
As Amended May 4, 2000

AMENDMENT 1

On page 2, lines 23 and 27, and on page 7, lines 4 and 8, strikeout "(g)" and at each instance thereof insert:

(f)

AMENDMENT 2

On page 2, line 26, and on page 7, line 7, strikeout "subparagraph (A) of "

AMENDMENT 3

On page 3, strikeout line 35, and on page 8, strikeout line 10, and insert:

year. The number of employees

AMENDMENT 4

On page 3, line 40, and on page 8, line 15, after "the" insert:

beginning of the

AMENDMENT 5

On page 4, line 4, and on page 8, line 19, strike out "eligible individual" and insert:

employee

AMENDMENT 6

On page 4, line 12, and on page 8, line 26, after "services" insert:

in California

AMENDMENT 7

On page 6, lines 13 and 14, and on page 10, lines 30 and 31, strikeout "at least annually, or more frequently" and insert:

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