

FINAL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	Hernandez, et al.	SBX2-2

SUBJECT

Income Exclusion / Qualified Health Service Plan Income

SUMMARY

This bill would establish the Managed Care Organization Provider (MCO) tax, provide a reduction to the gross premiums tax, and exclude certain income under the Corporation Tax Law (CTL).

This analysis only addresses the provision relating to the exclusion of income under the CTL and not the provisions related to the gross premiums tax or the MCO tax.

REASON FOR THE BILL

The reason for the bill is to enact permanent and sustainable funding from the new MCO tax that meets federal funding requirements and reform the taxes paid by entities subject to the new MCO tax.

EFFECTIVE/OPERATIVE DATE

As a special session enactment, this bill would be effective on the 91st day after adjournment of the 2015-2016 second extraordinary session if enacted.

This exclusion of income under the CTL would be operative for qualified health care service plan income of a qualified health care service plan properly accrued with respect to enrollment or services that occur on or after July 1, 2016, and on or before June 30, 2019, subject to uncodified provisions discussed below.

FEDERAL/STATE LAW

Existing federal and state corporation laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Examples of exclusions include income from certain discharges of indebtedness, federal energy grants, and life insurance receipts.

State law provides that when income from a taxpayer is partially or completely excluded from the measure of the income or franchise tax, the factors associated with the excluded income are excluded from the numerator and denominator of an apportioning trade or business.¹

State law disallows any amount otherwise allowable as a deduction where the expense is allocable to one or more classes of income not included in the measure of income or franchise

¹ Legal Ruling 2006-01 (April 28, 2006). https://www.ftb.ca.gov/law/rulings/active/lr06_01.pdf.

tax.² Under state law, corporations that incorporate, qualify or start doing business in California, are subject to the minimum franchise tax. The minimum franchise tax amount for the second tax year and all subsequent tax years is \$800.

THIS BILL

This bill would allow the qualified health care service plan income of a qualified health care service plan properly accrued with respect to enrollment or services that occur on or after July 1, 2016, and on or before June 30, 2019, to be excluded from gross income under the CTL.

In addition, a qualified health care service plan with no income, other than qualified health care service plan income that is excluded from gross income for a taxable year, would be exempt from the minimum franchise tax for that taxable year.

This bill would define the following phrases:

- “Qualified health care service plan” means a health care service plan, as defined in subdivision (k) of Section 14199.51 of the Welfare and Institutions Code³ that is subject to the MCO tax.⁴
- “Qualified health care service plan income” means the revenue listed below, inclusive, that is associated with the operation of a qualified health care service plan and that is required to be reported to the Department of Managed Health Care pursuant to the Instructions for filing Financial Statements and Section 1384 of the Health and Safety Code and the regulations adopted thereunder:
 - Premiums (commercial).
 - Copayments, COB, subrogation.
 - Title XIX Medicaid.
 - Point-of-Service premiums.
 - Risk pool revenue.
 - Capitation payments.
 - Title XVIII Medicare.
 - Fee-for-service.
 - Interest.
 - Aggregate write-ins for other revenues, including capital gains and other investment income.

² Revenue and Taxation Code section 24425.

³ This bill would add Section 14199.51 of the Welfare and Institution’s Code (WIC), which would include the definition of a “health care service plan” to mean a health care service plan, other than a plan that provides only specialized or discount services, that is licensed by the Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975 (Chapter 2.2 (commencing with Section 1340) of Division 2 of the Health and Safety Code) or a managed care plan contracted with the State Department of Health Care Services to provide Medi-Cal services.

⁴ The MCO tax would be imposed under Section 14199.54 of the WIC, which would be added by this bill.

No later than December 1, 2016, and annually thereafter, the State Department of Health Care Services would provide to the Franchise Tax Board (FTB) information regarding every health care service plan that is subject to the MCO tax, including:

- The corporate name, address, and calendar period for which each health care service plan is subject to the MCO tax, and,
- If applicable, the owner or owners of those health care service plans.

The FTB could prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this exclusion of income, and would be exempt from the Administrative Procedure Act.

This bill would remain in effect only until December 1, 2019, and as of June 30, 2020, would be repealed.

This bill also would express legislative intent that the FTB Legal Ruling 2006-01 (April 28, 2006), regarding the treatment of apportionment factors attributable to income exempt from income tax, would apply to apportionment factors attributable to the income of qualified health care service plans excluded by this bill.

In addition, this bill would provide the following off-code language:

- This bill would become effective and operative on the later of July 1, 2016, or the effective date, certified in writing by the Director of Health Care Services, of the federal approval necessary for receipt of federal financial participation in conjunction with the MCO tax. The Director of Health Care Services would post the certification of federal approval on the State Department of Health Care Services' Internet Web site and send a copy of the certification to the Executive Officer of the FTB.
- This bill would cease to be operative the first day of the state fiscal year beginning on or after the date the Director of Health Care Services, in consultation with the Director of Finance, determines that the taxes have not met the intent of the Welfare and Institutions Code for the purposes of providing funding for health care and prevention, or the state does not have the federal approval necessary for the receipt of federal financial participation in conjunction with the MCO tax. The Director of Health Care Services would post the determination on the State Department of Health Care Services' Internet Web site and send a copy to the Executive Officer of the FTB.
- This bill would cease to be operative the first day of the state fiscal year beginning on or after the effective date of a final judicial determination made by any court of appellate jurisdiction that this bill cannot be implemented. The Director of the Health Care Services would post a notification of the final judicial determination on the State Department of Health Care Services Internet Web site and provide this notification the Executive Officer of the FTB.

LEGISLATIVE HISTORY

SBX2-15 (Hernandez, 2015/2016), identical to this bill, would create an MCO tax, reduce gross premiums tax, and provide an exclusion under the CTL. SBX2-15 is pending before the Senate Public Health & Developmental Services.

ABX2-20 (Bonta & Levine, 2015/2016), identical to this bill, would create an MCO tax, reduce gross premiums tax, and provide an exclusion under the CTL. ABX2-20 is pending before the Assembly Public Health and Developmental Services Committee

FISCAL IMPACT

Staff estimates a cost of approximately \$24,000 for fiscal year 2015/2016, \$194,000 for fiscal year 2016/2017, and ongoing costs of \$ 53,000 for fiscal year 2017/2018 and thereafter to process qualified plan information. The department would pursue a budget change proposal if necessary.

ECONOMIC IMPACT

The exclusion from income under the CTL would result in a revenue loss. The FTB defers to the Department of Finance for the estimated economic impact of that exclusion.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

VOTES

	Date	Yes	No
Assembly Floor	02/29/16	61	16
Senate Floor	02/29/16	28	11

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