

chair **Betty T. Yee**
member **Diane L. Harkey**
member **Michael Cohen**



STATE OF CALIFORNIA
Franchise Tax Board

Summary of Federal Income Tax Changes
2016

Laws Affected

Personal Income Tax Law

Corporation Tax Law

Administration of Franchise and Income Tax Laws

Summary of Federal Income Tax Changes
2016

Prepared by the Staff of the
Franchise Tax Board
STATE OF CALIFORNIA

Members of the Board:
Betty T. Yee, Chair
Diane L. Harkey, Member
Michael Cohen, Member

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This report is submitted in fulfillment of the requirement in Revenue and Taxation Code section 19522.

Summary of Federal Income Tax Changes – 2016

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Summary of Federal Income Tax Changes – 2016

EXECUTIVE SUMMARY

Prepared by the Staff of the
Franchise Tax Board (FTB)
State of California

During 2016, the Internal Revenue Code (IRC) or its application by California was changed by:

PUBLIC LAW	TITLE	DATE
114-125	Trade Facilitation and Trade Enforcement Act of 2015	February 24, 2016
114-184	Recovering Missing Children Act	June 30, 2016
114-239	United States Appreciation for Olympians and Paralympians Act of 2016	October 7, 2016
114-255	21st Century Cures Act	December 13, 2016
114-292	Combat-Injured Veterans Tax Fairness Act of 2016	December 16, 2016
114-125, 114-141, 114-190	Miscellaneous Federal Acts Impacting the IRC Not Requiring a California Response	Various

Summary of Federal Income Tax Changes – 2016

This report explains the new 2016 federal laws along with the effective dates, the corresponding California law, if any, including an explanation of any changes made in response to the new federal law, and the impact on California revenue if California were to conform to applicable federal changes.

This report also contains citations to the section numbers of federal Public Laws, the IRC, and the California Revenue and Taxation Code (R&TC) impacted by the federal changes.

This report contains the following exhibits:

- Exhibit A *2016 Miscellaneous Federal Acts Impacting the IRC Not Requiring a California Response* - Short explanations of federal law changes that are either not administered by the FTB or are not applicable to California.
- Exhibit B *Expiring Tax Provisions* - A complete listing of expiring provisions in California tax law.
- Exhibit C *Revenue Tables* - The impact on California revenue were California to conform to the federal changes.

Trade Facilitation and Trade Enforcement Act of 2015
Public Law 114-125, February 24, 2016

<u>Section</u>	<u>Section Title</u>
921	Increase in Penalty for Failure to File Return of Tax

Background

Under present law, a taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent.¹ An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

In the case of a failure to file a tax return within 60 days of the due date, present law imposes a minimum penalty equal to the lesser of \$135 (indexed annually by an inflation adjustment) or 100 percent of the amount of tax required to be shown on the return.

New Federal Law (IRC section 6651)

This provision increased the base minimum tax penalty, for failure to file a tax return within 60 days of the due date, including the extension from \$135 to \$205 for returns required to be filed on or after January 1, 2016.

Effective Date

This provision is effective for returns required to be filed on or after January 1, 2016.

California Law (R&TC section 19131)

California does not conform by reference to IRC section 6651, relating to failure to file tax return or to pay tax, but instead has stand-alone language that parallels the federal provision. California law provides that a taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent.² An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.³

¹ IRC section 6651(a)(1).

² R&TC section 19131(a).

³ R&TC section 19131(c).

Trade Facilitation and Trade Enforcement Act of 2015
Public Law 114-125, February 24, 2016

In the case of a failure of an individual or fiduciary to file a tax return within 60 days of the due date, California law imposes a minimum penalty equal to the lesser of \$135 or 100 percent of the amount of tax required to be shown on the return.⁴

Impact on California Revenue

Estimated Conformity Revenue Impact of Increase in Penalty for Failure to File Return of Tax For Taxable Years Beginning On or After January 1, 2017 Enactment Assumed After June 30, 2017			
2016-17	2017-18	2018-19	2019-20
\$800,000	\$3,500,000	\$2,800,000	\$2,800,000

⁴ R&TC section 19131(b).

Recovering Missing Children Act
Public Law 114-184, June 30, 2016

<u>Section</u>	<u>Section Title</u>
2	Disclosure of Certain Return Information Relating to Missing or Exploited Children Investigations

Background

IRC section 6103 provides the general rule that returns and return information are confidential. IRC section 6103 also states that returns and return information are not to be disclosed unless such disclosure is specifically authorized in IRC section 6103 or other provision of the IRC.⁵

Definition of Return

A “return” means any tax or information return, declaration of estimated tax, or claim for refund which, under the IRC, is required (or permitted) to be filed on behalf of, or with respect to, any person. It also includes any amendment, supplemental schedule or attachment filed with the tax return, information return, declaration of estimated tax, or claim for refund. For example, Form W-2, Wage and Tax Statement is an information return of both the employer who filed it with the IRS and the employee with respect to whom it was filed.

Definition of Return Information

The IRC defines “return information” broadly. It includes a taxpayer's identity (the name of the person with respect to whom a return is filed, his mailing address, his taxpayer identifying number (Taxpayer Identification Number or Social Security number or a combination thereof)). In addition to taxpayer identity, return information includes any information gathered by the Internal Revenue Service (IRS) with regard to a taxpayer's liability under the IRC.⁶

⁵ See IRC section 6103(c) (disclosure by taxpayer consent); 6103(d) (disclosure to State tax officials); 6103(e) (disclosure to persons having material interest); 6103(f) (disclosure to committees of Congress); 6103(g) (disclosure to the President and certain other persons); 6103(h) (disclosure to Federal officers and employees for tax administration purposes); 6103(i) (disclosure to Federal officers and employees for administration of Federal laws not relating to tax administration); 6103(j) (statistical use); 6103(k) (disclosure of certain returns and return information for tax administration purposes); 6103(l) (disclosure for purposes other than tax administration); 6103(m) (disclosure of taxpayer identity information); 6103(n) (tax administration contractors); and 6103(o) (disclosure of return and return information with respect to certain taxes).

⁶ In addition to a taxpayer's identity, return information also is:

- The nature, source or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments;
- Whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing;
- Any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under Title 26 for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense;
- Any part of any written determination or any background file document relating to such written determination which is not open to public inspection under IRC section 6110;
- Any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to the agreement or any application for an advance pricing agreement; and
- Any agreement under IRC section 7121 (relating to closing agreements), and any similar agreement, and any background information related to such agreement or request for such agreement (IRC section 6103(b)(2)).

The term “return information” does not include data in a form that cannot be associated with or otherwise identify, directly or indirectly, a particular taxpayer. However, return information that has merely had the identifiers (name, address, SSN) removed remains protected by IRC section 6103.

Definition of “Taxpayer Return Information”

“Taxpayer return information” is another defined term for purposes of IRC section 6103 and is a subset of return information. “Taxpayer return information” means return information that is filed with, or furnished to, the IRS by or on behalf of the taxpayer to whom such return information relates. For example, information filed with the IRS by a taxpayer's attorney or accountant is taxpayer return information. Information transcribed directly from a taxpayer's return is taxpayer return information. The distinction between return information and taxpayer return information is significant for disclosures in non-tax criminal matters for which a court order generally is required to obtain “taxpayer return information.”

Recordkeeping, Safeguards, Penalties for Unauthorized Disclosure

IRC section 6103 requires that certain recordkeeping and safeguard requirements be met by authorized recipients, as specified, of returns and return information (IRC section 6103(p)(4)) as a condition of receiving such information. These requirements establish a system of records to track disclosure requests and disclosures, ensure that returns and return information are securely stored, and that access to returns and return information is restricted to authorized persons. These requirements and restrictions are intended to ensure that an individual's right to privacy is not unduly compromised and return and return information is not misused or improperly disclosed. The IRS also must submit reports to the Joint Committee on Taxation and to the public regarding requests for and disclosures made of returns and return information 90 days after the close of the calendar year (IRC section 6103(p)(3)).

Criminal sanctions apply to the unauthorized disclosure or inspection of returns and return information (IRC sections 7213, 7213A, and 7431) including fines, jail time, and for Federal employees, dismissal or discharge from office upon conviction.

Disclosure Exception for Non-Tax Criminal Purposes:

Disclosure of Returns and Return Information Pursuant to Ex Parte Court Order

A Federal agency enforcing a non-tax criminal law must obtain an ex parte court order to receive a return or taxpayer return information (i.e., that information submitted by or on behalf of a taxpayer to the IRS) (IRC section 6103(i)(1)).⁷ Only specified Federal law enforcement officials—the Attorney General, Deputy Attorney General, Assistant Attorney Generals, United States Attorneys, Independent Counsels, or an attorney in charge of an organized crime strike force may authorize an application for the order.

⁷ Return information other than that submitted by the taxpayer may be obtained by ex parte court order under this provision as well.

Recovering Missing Children Act
Public Law 114-184, June 30, 2016

A judge or magistrate may grant the application for court order if it is determined, on the basis of the facts submitted by the applicant, that:

- There is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed;
- There is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act;
- The return or taxpayer return information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such act; and
- The information sought cannot reasonably be obtained under the circumstances from another source.

Pursuant to the ex parte order, the information may be disclosed to officers and employees of the Federal agency who are personally and directly engaged in: (1) the preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is a party; (2) any investigation which may result in such a proceeding; or (3) any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party. The information can be used solely by such officers and employees in such preparation, investigation, or grand jury proceeding.

With respect to terrorist activities, an order may be granted if there is: (1) reasonable cause to believe, based upon information believed to be reliable, that the return or taxpayer return information may be relevant to a matter relating to a terrorist incident, threat or activity; and (2) the return or taxpayer return information is sought exclusively for use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat or activity. The return or taxpayer return information may be shared with a State and local law enforcement agency if such law enforcement agency is part of a team with the Federal law enforcement agency and then only disclosed to such State and local law enforcement officers and employees who are personally and directly engaged in the investigation or response to terrorist activity and can be used only for that purpose.

Disclosure without a Court Order (Information Obtained from a Source Other than the Taxpayer)

A court order is not required for the disclosure of return information obtained from a source other than the taxpayer. This authority allows the IRS to make disclosures of return information (other than “taxpayer return information”) to apprise the appropriate Federal officials of possible violations of Federal criminal law, and to respond to requests from the head of any Federal agency and certain other Federal officials responsible for non-tax Federal criminal purposes.

The IRS may also disclose return information to Federal and State law enforcement agencies in cases of imminent danger of death or physical injury. The statute does not grant authority, however, to disclose return information to local law enforcement, such as city, county, or town police.

Recovering Missing Children Act
Public Law 114-184, June 30, 2016

New Federal Law (IRC section 6103)

The provision permits specified Federal law enforcement officials to seek an ex parte court order for the disclosure of return and taxpayer return information in cases of missing or exploited children. A judge or magistrate may grant the application if, on the basis of facts submitted by the applicant, it is determined that: (1) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed; (2) there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act; and (3) the return or return information is sought exclusively, for use in a criminal investigation or proceeding in the case of a matter relating to a missing or exploited child, and the return or return information sought cannot reasonably be obtained under the circumstances from another source.

Upon the grant of the ex parte court order, the return or return information may be disclosed to Federal officers and employees who are personally and directly engaged in:

- The preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is a party or pertaining to the case of a missing or exploited child,
- Any investigation which may result in such a proceeding, or
- Any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party or pertaining to such a case of a missing or exploited child.

The provision allows, upon the grant of an ex parte court order application made by a specified Federal law enforcement official, the head of the Federal agency (or his designee) to disclose returns (including tax returns and information returns) and taxpayer return information to officers and employees of State or local law enforcement agencies who are: (1) part of a team with the Federal agency in investigations of missing or exploited child cases; and (2) who are personally and directly engaged in such investigations. The provision limits the use of such information to locating a missing child, use in a grand jury proceeding, or use in any preparation for judicial or administrative proceedings.

The recipient State and local law enforcement agency and its personnel are subject to the general rule of confidentiality, safeguard requirements, and civil and criminal penalties for the unauthorized disclosure or inspection of returns or taxpayer return information.

Under the provision, the term “missing child” means any individual less than 18 years of age whose whereabouts are unknown to such individual's legal custodian.⁸ An “exploited child” means a minor with respect to whom there is reason to believe that a specified offense against a minor (as defined by section 117(7) of the Sex Offender Registration and Notification Act) has occurred or is occurring.⁹ Such specified offenses include: (1) an offense involving (unless

⁸ The meaning given such term by section 403 of the Missing Children's Assistance Act. (42 U.S.C. section 5772).

⁹ 42 U.S.C. section 116911(7).

Recovering Missing Children Act
Public Law 114-184, June 30, 2016

committed by a parent or guardian) kidnapping; (2) an offense (unless committed by a parent or guardian) involving false imprisonment; (3) solicitation to engage in sexual conduct; (4) use in a sexual performance; (5) solicitation to practice prostitution; (6) video voyeurism as described in section 1801 of Title 18; (7) possession, production, or distribution of child pornography; (8) criminal sexual conduct involving a minor or the use of the Internet to facilitate or attempt such conduct; or (9) any conduct that by its nature is a sex offense against a minor.

Effective Date

The provision is effective for disclosures made after the date of enactment (June 30, 2016).

California Law (R&TC sections 19542 - 19572)

California does not currently conform to IRC section 6103. However, with respect to federal tax information, the FTB is subject to the confidentiality and disclosure rules of IRC section 6103.¹⁰

Prior to January 1, 2006, California law temporarily allowed the disclosure of return and return information to appropriate federal agencies engaged in terrorism and national security investigations in the same manner as such information could be disclosed by the secretary under federal law.¹¹

California law contains confidentiality and disclosure rules specifically applicable to state tax information.¹²

Impact on California Revenue

No impact.

¹⁰ IRC section 6103(a)(2) generally provides that no officer or employee of any state or local law enforcement agency who has or had access to federal tax information is allowed to disclose such information in any manner in connection with that officer's or employee's state service, and violations of that rule may result in penalties, imprisonment, or both, pursuant to IRC section 7213A, relating to unauthorized inspection of returns or return information.

¹¹ Victims of Terrorism Tax Relief Act of 2001 (PL 107-34), SB 219 (Stats. 2002, Ch. 807).

¹² R&TC sections 19542 - 19572.

United States Appreciation for Olympians and Paralympians Act of 2016
Public Law 114-239, October 7, 2016

<u>Section</u>	<u>Section Title</u>
2	Olympic and Paralympic Medals and United States Olympic Committee (USOC) Prize Money Excluded from Gross Income

Background

Under present law, U.S. citizens and residents are subject to U.S. taxation on their worldwide income, from whatever source derived,¹³ absent a specific statutory exception. Prizes and awards are specifically included in income.¹⁴ If prizes or awards are provided in the form of goods or services, the fair market value of the goods or services provided is the amount to be included in income.¹⁵

There are three exceptions to the general rule of inclusion of prizes and awards: first, qualified scholarships described in IRC section 117; second, certain employee achievement awards; and third, awards for religious, charitable, scientific, educational, artistic, literary, or civic achievement, provided that the recipient takes no action to be considered for the award, requests that the monetary award be transferred to a designated governmental unit or tax-exempt organization to which deductible charitable contributions are permitted, and is not required to render future substantial services as a condition of the award.¹⁶

Examples of awards that may qualify for the third exception if the monies associated with the award, are timely donated include the Nobel and Pulitzer prizes. In contrast, prizes or awards in recognition of athletic achievement are generally ineligible for the exception.

The USOC is a corporation created by statute to serve as a coordinating body for United States participation in international competitive amateur sports, in order to provide “the most competent amateur representation possible in each event” in the Olympic, Paralympic and Pan-American Games.¹⁷ As part of its activities, the USOC awards each U.S. Olympic athlete prize money for each medal won, in the amounts of \$25,000 for each gold medal, \$15,000 for each silver medal,

¹³ IRC section 61.

¹⁴ IRC section 74.

¹⁵ IRS Treas. Reg. section 1.74-1(a)(2).

¹⁶ IRS Treas. Reg. section 1.74-1(b).

¹⁷ See generally, 36 U.S.C. sections. 220501 through 220512. The organization does not generally receive Federal funding, although specific programs for veterans of U.S. military service receive Federal assistance. Instead, the organization raises funds from donors as well as revenue from licensing of use of the US Olympic team name and insignia, as well as granting of broadcast rights in the United States. The purposes of the organization are enumerated in section 220503, and include promotion of physical fitness and sports participation generally, financial assistance to athletes or sport federations, development of training facilities and technical support to amateur athletic programs that support sports that are included in the Olympics, Paralympics and Pan-Am games. The USOC provides a quadrennial report to Congress on its operations. The most recent report, covering the period 2009 through 2012, was issued June 1, 2013, and is available at <http://www.teamusa.org/Footer/Legal/Governance-Documents>.

United States Appreciation for Olympians and Paralympians Act of 2016
Public Law 114-239, October 7, 2016

and \$10,000 for each bronze medal. U.S. Paralympic athletes receive \$5,000, \$3,500, and \$2,500, respectively for each gold, silver, and bronze medal awarded. Because all U.S. Olympians and U.S. Paralympians are required to be U.S. citizens, the prize money awarded to these individuals by the USOC, as well as the fair market value of gold, silver, and bronze medals, is includible in gross income as prizes and awards, regardless of whether the athletes derive the income from activities performed inside or outside the United States.

New Federal Law (IRC section 74)

This provision created a new exception to the general rule requiring inclusion of prizes and awards in gross income. Under terms of the exception, neither the value of the medals awarded to the U.S. Olympic or U.S. Paralympic athletes nor the cash prizes given by the USOC are includible in income for federal tax purposes. This exclusion does not apply to taxpayers whose adjusted gross income (determined without regard to the value of such medals or rewards) is in excess of \$1,000,000 (or half such amount in the case of a married taxpayer filing a separate return).

Effective Date

The exclusion is effective for prizes and awards received from the USOC after December 31, 2015.

California Law

California generally conforms to IRC section 74 for the calculation of gross income as of the “specified date” of January 1, 2015,¹⁸ and thus does not conform to this provision’s exclusion from gross income.¹⁹

Impact on California Revenue

Estimated Conformity Revenue Impact of Olympic and Paralympic Medals and USOC Prize Money Excluded from Gross Income For Taxable Years Beginning On or After January 1, 2017 Enactment Assumed After June 30, 2017			
2016-17	2017-18	2018-19	2019-20
\$0	- < \$10,000	- < \$10,000	- \$50,000

¹⁸ R&TC section 17081 conforms to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, containing IRC sections 101 to 138, as of the “specified date” of January 1, 2015, with modifications.

¹⁹ Legislation was introduced on February 12, 2016, that would have provided a similar exclusion under California law (AB 1944, held in committee under submission and released on 11/30/2016).

21st Century Cures Act
Public Law 114-255, December 13, 2016

<u>Section</u>	<u>Section Title</u>
18001	Exception from Group Health Plan Requirements for Qualified Small Employer Health Reimbursement Arrangements

Background

Exclusion for Employer-Provided Health Benefits

An employee may exclude from gross income amounts provided through an arrangement under which: (1) an employer pays or reimburses premiums for health insurance for the employee and family members purchased in the individual insurance market (referred to as an employer payment plan); or (2) an employer reimburses the employee for medical expenses generally of the employee and family members (referred to as a health reimbursement arrangement or “HRA”).²⁰ For employer payments or reimbursements under these arrangements to be excluded from gross income, premiums and other expenses must be substantiated and an employee must be entitled to receive payments from the employer only if he or she incurs qualifying expenses.²¹

The exclusion also applies to amounts paid or reimbursed from funds withheld from an employee’s salary under a cafeteria plan (“salary reduction amounts”).²²

The value of employer-provided health benefits for a year is generally required to be reported by the employer on an employee’s Form W-2, Wage and Tax Statement, for the year.²³

Group Health Plan Requirements

The IRC, Employee Retirement Income Security Act (ERISA), and the Provincial Health Services Authority (PHSA) impose various requirements with respect to employer-sponsored health plans, referred to for this purpose as group health plans.²⁴

²⁰ IRC sections. 105(b) and 106; Rev. Rul. 61-146, 1961-2 C.B. 25; Notice 2002-45, 2002-2 C.B. 93, and Rev. Rul. 2002-41, 2002-2 C.B. 75. Under IRC section 105(h), a self-insured medical reimbursement plan must meet certain nondiscrimination requirements in order for the benefits provided to a highly compensated individual to be excluded from income. For this purpose, the following groups of employees may be excluded: employees who have not completed three years of service with the employer, employees under age 25, part-time or seasonal employees, employees covered by a collective bargaining agreement if health benefits were the subject of good faith bargaining, and nonresident aliens with no earned income from sources within the United States. Employer payments and reimbursements for health insurance and medical expenses are also excluded from wages for employment tax purposes. IRC Secs. 3121(a)(2), 3231(e)(1), 3306(b)(2), 3401(a)(20), Rev. Rul. 56-632, 1956-2 C.B. 101.

²¹ Treas. Reg. section 1.105-2.

²² IRC section 125. An HRA cannot include salary reduction amounts.

²³ IRC section 6051(a)(14).

²⁴ IRC sections 4980B (relating to continuation coverage or “COBRA” requirements) and 5000 (relating to Medicare secondary payor requirements) and Chapter 100 (secs. 9801-9834, relating to various additional requirements, such as prohibitions on preexisting condition exclusions and discrimination based on health status); Title I, Parts 6 and 7, of ERISA; Title XXVII of the PHSA.

21st Century Cures Act
Public Law 114-255, December 13, 2016

Under the IRC, an employer is generally subject to an excise tax of \$100 a day per affected individual if it sponsors a group health plan that fails to meet any of these requirements.²⁵ In some cases, the excise tax does not apply if the failure is due to reasonable cause and not to willful neglect and the failure is corrected within a certain period. In addition, in some cases in which failure is due to reasonable cause and not to willful neglect, some or all of the excise tax may be waived to the extent payment of the tax would be excessive relative to the failure involved.

IRS guidance holds that employer payment plans generally fail to meet certain group health plan requirements.²⁶ In addition, an HRA fails to meet those requirements unless the HRA has complied with IRS rules relating to HRAs provided in conjunction with (or “integrated” with) certain other employer-sponsored coverage that meets the group health plan requirements. An HRA that is integrated with such employer-sponsored coverage is often referred to as an “integrated” HRA, and an HRA that is not integrated with such employer-sponsored coverage is often referred to as a “stand-alone” HRA. Thus, an employer may be subject to an excise tax if it provides an employer payment plan or a stand-alone HRA.

Other Health Rules under the Code

Individuals are generally required to have health coverage, referred to as minimum essential coverage.²⁷ Unless an exception applies, an individual who fails to have minimum essential coverage may be subject to a tax penalty. Minimum essential coverage includes employer-sponsored coverage under a group health plan, other than certain types of limited coverage, such as coverage only for vision or dental medical services. Minimum essential coverage also includes coverage purchased in the individual insurance market, other than certain types of limited coverage, such as coverage only for vision or dental medical services.

An advanceable, refundable income tax credit (premium assistance credit) is available to certain individuals who purchase health insurance coverage (coverage) in the individual market through an American Health Benefit Exchange (Exchange).²⁸ However, an individual is generally not eligible for the credit if his or her employer offers affordable minimum essential coverage under a group health plan and the coverage provides minimum value. For this purpose, coverage is affordable if the employee’s share of the premium for self-only coverage under the group health plan is not more than 9.5 percent²⁹ of the employee’s household income. To provide minimum value, the coverage offered under the group health plan must cover at least 60 percent of the total costs of benefits covered under the plan. An individual who applies for advance premium

²⁵ IRC sections 4980B(a) and (b) (COBRA), 4980D(a) and (b) (Chapter 100), 5000(a) (Medicare secondary payor requirements). IRC Sec. 4980B(d)(1) provides an exception for plans of employers with fewer than 20 employees. IRC section. 4980D(d)(1) provides an exception for a plan of an employer with no more than 50 employees if coverage is provided solely through insurance. In some cases, a party other than the employer, such as a multiemployer plan, may be liable for the tax.

²⁶ Notice 2015-17, 2015-14 I.R.B. 845, and Notice 2013-54, 2013-2 C.B. 287. Notice 2015-17 provides relief from the excise tax under section 4980D for periods before July 1, 2015, for certain small employers.

²⁷ IRC section 5000A.

²⁸ IRC section 36B.

²⁹ For years after 2014, this percentage is increased as needed to reflect cost-of-living increases. The percentage for 2016 is 9.66.

21st Century Cures Act
Public Law 114-255, December 13, 2016

assistance with respect to Exchange coverage for a year must provide the Exchange with certain information, including information relating to employer-provided minimum essential coverage.³⁰

If an applicable large employer fails to offer employees minimum essential coverage, or offers minimum essential coverage that either is unaffordable (under the standard described above) or fails to provide minimum value, and any employee receives a premium assistance credit, the employer may be subject to a tax penalty.³¹ For this purpose, applicable large employer generally means, with respect to a calendar year, an employer who employed an average of at least 50 full-time employees (including full-time equivalents) on business days during the preceding calendar year.³²

Effective 2020, the high-cost coverage excise tax, commonly also referred to as the “Cadillac” tax applies if the aggregate cost of employer-provided coverage provided to an employee under an employer’s group health plans exceeds a specified amount.³³ The aggregate cost of coverage for this purpose generally includes the cost of all types of coverage provided by the employer’s group health plans, other than certain types of limited coverage, such as coverage only for vision or dental medical services.

New Federal Law (IRC sections 36B, 106, 4980I, 6051, 6652, & 9831)

Qualified Small Employer Health Reimbursement Arrangement

Under this provision, a “qualified small employer health reimbursement arrangement” (referred to herein as a QSEHRA) is generally not a group health plan under the IRC, ERISA, or PHSa and thus is not subject to the group health plan requirements.³⁴ A QSEHRA is defined as an arrangement: (1) that is provided on the same terms to all eligible employees of an eligible employer (with certain permitted variation, discussed below); (2) that is funded solely by the eligible employer and no salary reduction contributions may be made under the arrangement; (3) that provides, after an employee provides proof of minimum essential coverage, for the payment or

³⁰ Section 1411(b) of the Patient Protection and Affordable Care Act (“PPACA”), Pub. L. No. 110-148. This information is subject to verification during the Exchange process under section 1411(c) and (d) of the PPACA.

³¹ IRC section 4980H.

³² In determining whether an employer is an applicable large employer (that is, whether the employer has at least 50 full-time employees), besides the number of full-time employees, the employer must include the number of its full time equivalent employees for a month, determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120. In addition, in determining applicable large employer status, members of the same controlled group, group under common control, and affiliated service group under section IRC 414(b), (c), (m) and (o) are treated as a single employer.

³³ IRC section 4980I.

³⁴ A QSEHRA continues to be treated as a group health plan as defined under the PHSa, for purposes of applying that definition to the privacy requirements applicable to medical information under the Health Insurance Portability and Accountability Act of 1996 (referred to as HIPAA), Part C of Title XI of the Social Security Act. In addition, as discussed below, a QSEHRA continues to be treated as a group health plan for purposes of the excise tax on high-cost coverage. Moreover, the provision does not change the extent to which a QSEHRA is an employee welfare benefit plan under ERISA and subject to ERISA requirements other than the group health plan requirements.

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reimbursement of medical expenses of the employee and family members;³⁵ and (4) under which the amount of payments and reimbursements for a year cannot exceed specified dollar limits. The initial dollar limits are \$4,950 (\$10,000 in the case of expenses of an employee and family members). For years after 2016, the dollar limits are increased as needed to reflect cost of living increases, with rounding down to the next lowest multiple of \$50.³⁶

The maximum dollar amount of payments or reimbursements that may be made under a QSEHRA with respect to an eligible employee for a year is the employee's "permitted benefit." An arrangement does not fail to be provided on the same terms to all eligible employees merely because employees' permitted benefits vary with the price of a health insurance policy in the individual insurance market based on the ages of the employee and family members or the number of family members covered by the arrangement, provided that the variation is determined by reference to the same insurance policy for all eligible employees.

Under this provision, "eligible employee" means any employee of an eligible employer, except that the terms of the QSEHRA may exclude employees who have not completed 90 days of service with the employer, employees under age 25, part-time or seasonal employees, employees covered by a collective bargaining agreement if health benefits were the subject of good faith bargaining, and nonresident aliens with no earned income from sources within the United States.³⁷ "Eligible employer" means an employer that: (1) is not an applicable large employer as defined for purposes of the requirement that an applicable large employer offer its employees minimum essential coverage (that is, generally, an employer with fewer than 50 full-time employees and full-time equivalents during the preceding year); and (2) does not offer a group health plan to any of its employees.

Income Tax Treatment of QSEHRA Benefits

Except as discussed in the following paragraph, coverage and payments or reimbursements under a QSEHRA are excluded from gross income to the extent they would be excluded under present law.

Because a QSEHRA is not a group health plan, coverage under a QSEHRA is not minimum essential coverage and does not satisfy the requirement that an individual have minimum essential coverage. Under this provision, if an employee's medical care expenses are paid or reimbursed under a QSEHRA and the employee does not have minimum essential coverage for the month in which the medical care was provided, the amount of the payment or reimbursement for those expenses is includible in the employee's income.³⁸

³⁵ The provision specifies that the Secretary of the Treasury or his designee may issue substantiation requirements as necessary to carry out the provision.

³⁶ In the case of an individual not covered by the arrangement for all 12 months of a year, the dollar amounts are prorated to reflect the number of months of coverage.

³⁷ These groups are based on the groups that can be excluded in applying the nondiscrimination requirements under IRC section 105(h) to a self-insured plan with 90 days of service substituted for three years of service.

³⁸ This provision does not change the treatment of such payments or reimbursements for employment tax purposes. Thus, they continue to be excluded from wages for employment tax purposes.

Coordination with Other Code Rules

Under this provision, an eligible employee under a QSEHRA is not eligible for the premium assistance credit for a month if the QSEHRA constitutes affordable coverage for the month. For this purpose, a QSEHRA constitutes affordable coverage for a month if the excess of: (1) the employee's monthly premium for self-only coverage under the second lowest cost silver plan offered in the Exchange, over (2) 1/12 of the employee's permitted benefit under the QSEHRA, does not exceed 1/12 of 9.5 percent³⁹ of the employee's household income for the year. In the case of an eligible employee under a QSEHRA who is eligible for a premium assistance credit for a year (that is, the QSEHRA does not constitute affordable coverage), the credit amount is reduced (but not below zero) by the employee's permitted benefit.

Under this provision, a QSEHRA continues to be treated as a group health plan for purposes of the excise tax on high-cost coverage. For that purpose, an employee's permitted benefit is treated as the cost of coverage under the QSEHRA.

Notice and Reporting Requirements

This provision includes several requirements relating to notices and reporting.

Not later than 90 days before the beginning of a year in which an employer will fund a QSEHRA (or, if later, the date on which an employee becomes eligible for the QSEHRA), the employer must provide eligible employees with a written notice containing the amount of the employee's permitted benefit and certain other information. An employer that fails to provide the notice may be subject to a tax penalty of \$50 per employee, subject to a maximum of \$2,500 for the year.

In addition, the employer must report an employee's permitted benefit for a year on the employee's Form W-2 for the year. An eligible employee who applies for advance premium assistance with respect to Exchange coverage for a year must provide the Exchange with the amount of his or her permitted benefit for the year.

Effective Date

This provision generally applies to years beginning after December 31, 2016, (plan years beginning after December 31, 2016, in the case of the ERISA and the PHSA changes).⁴⁰ The aspects of the provision relating to the premium assistance credit apply to taxable years beginning after December 31, 2016. The requirement that an employer report an employee's permitted benefit on the employee's Form W-2 applies to calendar years beginning after December 31, 2016. With respect to the requirement that an employer provide written notice to eligible employees at least 90 days before the beginning of the year, an employer will not be treated as failing to provide the notice if it is provided no later than 90 days after date of enactment (December 13, 2016).

³⁹ For years after 2014, this percentage is increased as needed to reflect cost-of-living increases. The percentage for 2016 is 9.66.

⁴⁰ This provision extends the excise tax relief under Notice 2015-17 to plan years beginning on or before December 31, 2016.

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The requirement that an eligible employee applying for advance premium assistance provide the Exchange with the amount of his or her permitted benefit applies to applications for enrollment made after December 31, 2016. In the case of an application filed before April 1, 2017, the requirement is treated as met if the information is provided not later than 30 days after the date on which the employee receives the notice provided by the employer.⁴¹

California Law (R&TC sections 17131, 17131.4, 18631, & 19133.5)

California does not conform to IRC section 36B, which provides for a refundable credit for coverage costs under a qualified health plan.

California generally conforms to IRC section 106, which allows an exclusion from income for contributions by employers to accident and health plans as of the “specified date” of January 1, 2015,⁴² and thus does not conform to the amendments made to that section by this act.

California does not conform to IRC section 4980I, which imposes an excise tax on high cost employer-sponsored health coverage.

California generally conforms to IRC section 6051 (relating to receipts for employees). Since California does not conform to the new federal provisions under this act relating to a QSEHRA, Form W-2, Wage and Tax Statement amounts reported as paid or reimbursed under a QSEHRA, will not be applicable.

California does not conform to IRC section 6652. California has a stand-alone provision that is similar to IRC section 6652(k), which imposes a penalty for a failure to make a small business stock report.⁴³

California does not conform to IRC section 9831, which provides for general exceptions to group health plan requirements.

⁴¹ Verification of this information in the Exchange process applies with respect to months beginning after October 2016.

⁴² R&TC section 17131 conforms to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, containing IRC sections 101 to 138, as of the “specified date” of January 1, 2015, with modifications.

⁴³ R&TC section 19133.5.

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Impact on California Revenue

Estimated Conformity Revenue Impact of 21 st Century Cure Act of 2016, Section 18001 For Taxable Years Beginning On or After January 1, 2018 Enactment Assumed After June 30, 2017			
2016-17	2017-18	2018-19	2019-20
\$0	- \$2,400,000	- \$3,500,000	- \$1,100,000

Combat-Injured Veterans Tax Fairness Act of 2016
Public Law 114-292, December 16, 2016

<u>Section</u>	<u>Section Title</u>
3	Restoration of Amounts Improperly Withheld for Tax Purposes from Severance Payments to Veterans with Combat-Related Injuries

Background

Under present law, certain payments made as compensation for injuries or sickness are excluded from a taxpayer's gross income.⁴⁴ A disability severance payment received by an individual who is separating from the armed forces is excluded from gross income in two cases. First, if the individual received the disability severance payment as a result of a combat-related injury, such payment is excluded from taxable income.⁴⁵ Second, even if not related to a combat-related injury, if the disability severance payment recipient would, on application thereof, be entitled to receive disability compensation from the Department of Veterans Affairs (DVA), such payment is excluded from the recipient's taxable income.⁴⁶

In general, every employer making payment of wages is required to deduct and withhold tax upon such wages in accordance with tables or computational procedures prescribed by the Secretary.⁴⁷ As a general matter, severance pay is considered to be wages for these purposes.⁴⁸ However, amounts received that are excluded from income as described above (i.e., the severance payment was either on account of a combat-related injury or the recipient would be entitled to receive disability compensation from the DVA) are not subject to income tax withholding.⁴⁹

In general, in the case of an overpayment of tax, the Secretary may credit or refund the amount of the overpayment to the taxpayer.⁵⁰ The balance of the overpayment is generally refunded, unless a claim has been made for payment of certain non-tax debts of that person. As a general matter, any claim for credit or refund of an overpayment of any tax must be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within two years from the time the tax was paid.⁵¹

⁴⁴ IRC section 104.

⁴⁵ IRC sections 104(a)(4) and 104(b)(2)(C).

⁴⁶ IRC sections 104(a)(4) and 104(b)(2)(D).

⁴⁷ IRC section 3042(a)(1).

⁴⁸ Treas. Reg. section 31.3401(a)-1(b)(4).

⁴⁹ Treas. Reg. section 31.3401(a)-1(b)(1)(ii).

⁵⁰ IRC section 6402(a).

⁵¹ IRC section 6511(a).

Combat-Injured Veterans Tax Fairness Act of 2016
Public Law 114-292, December 16, 2016

New Federal Law (Uncodified Act section 3 affecting IRC sections 104 and 6511)

This provision requires that, not later than one year after the date of enactment (December 16, 2016) the Secretary of Defense identify certain disability severance payments made to veterans after January 17, 1991, from which income taxes were improperly withheld. Each individual so identified shall receive a notice of the amount of severance payments which were improperly withheld upon, and other information determined to be necessary by the Secretary of Treasury to carry out the purposes of the proposal. Each individual will receive instructions for filing an amended return to recover the improperly withheld amounts.

The provision extends the statute of limitations on claims for credit or refund, such that individuals who receive a notice of improper withholding have one year from the date of notice in which to file a claim for credit or refund (without regard to the date of payment).

The provision requires the Secretary of Defense to take such actions as may be necessary to ensure that amounts are not withheld for tax purposes from severance payments made by the Secretary of Defense to individuals when such payments are not considered gross income pursuant to IRC section 104(a)(4). The provision requires the Secretary of Defense to submit a report to Congress, specifying the number of individuals identified as having been improperly withheld upon, the aggregate amount improperly withheld, and a description of the actions to be taken to ensure that future payments are not improperly withheld.

Effective Date

This provision is effective on the date of enactment (December 16, 2016).

California Law (R&TC section 17131)

California generally conforms to the federal income exclusion of compensation received for injuries or sickness under IRC section 104, as of the “specified date” of January 1, 2015.⁵²

The effect of the federal provision is to open up the statute of limitations for those individuals who were subject to incorrect withholding on severance payments, received from the DVA, as a result of combat-related injuries. Consequently, California law provides that a claim for refund that is based on a federal change may be filed within two years from the date of the final federal determination.⁵³

Impact on California Revenue

Baseline.

⁵² R&TC section 17131 conforms to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, containing IRC sections 101 to 138, as of the “specified date” of January 1, 2015, with modifications.

⁵³ R&TC section 19311.

EXHIBIT A – 2016 MISCELLANEOUS FEDERAL ACTS IMPACTING THE IRC NOT REQUIRING A CALIFORNIA RESPONSE

- Public Law 114-125, the Trade Facilitation and Trade Enforcement Act of 2016, amends the IRC to modify any reference in law or regulations to the “Commissioner of Customs” or the “Commissioner of the Customs Service” to be deemed a reference to the Commissioner of the U.S. Customs and Border Protection.

IRC Section	Public Law No.	Act Section No.	130 Stat. Page
4672	114-125	802 (d)(2)	210

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- Public Law 114-141, the Airport and Airway Extension Act of 2016, amends the IRC to extend the specified date for funding of the taxes that support the Airport and Airway Trust Fund.

IRC Section	Public Law No.	Act Section No.	129 Stat. Page
1	114-141	1(a)	322
4081	114-141	202 (a)	324
4083	114-141	202 (c)(1)	324
4261	114-141	202 (b)(1)	324
4261	114-141	202 (c)(2)	325
4271	114-141	202 (b)(2)	324
9502	114-141	201	324

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- Public Law 114-190, the Federal Aviation Administration Extension, Safety, and Security Act of 2016, amends the IRC to extend the specified date for funding of the taxes that support the Airport and Airway Trust Fund.

IRC Section	Public Law No.	Act Section No.	129 Stat. Page
4081	114-190	1202 (a)	619
4083	114-190	1202 (c) (1)	619
4261	114-190	1202 (b)(1)	619
4261	114-190	1202 (c) (2)	619
4271	114-190	1202 (b)(2)	619
9502	114-190	1201	618

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset⁵⁴	California Sections	Federal Section	Federal Sunset	Description
12/31/17	17053.87 & 23687	N/A	N/A	College Access Tax Credit
12/31/17	18416.5	N/A	N/A	Allow Electronic Communication to Taxpayers to Inform of Tax Change
12/31/17	18741 - 18744	N/A	N/A	Voluntary Contribution: Fish and Game Preservation Fund
12/31/17	18791 - 18796	N/A	N/A	Voluntary Contribution: California Breast Cancer Research Fund
12/31/17	18861 - 18864	N/A	N/A	Voluntary Contribution: California Cancer Research Fund
12/31/17	17053.62 & 23662	45H	Permanent	Environmental Credit for Production of Ultra Low Sulfur Diesel Fuel
12/31/17	18705	N/A	N/A	Voluntary Contribution: State Children's Trust Fund for the Prevention of Child Abuse
12/31/18	17138.2 - 24308.2	N/A	N/A	Exclusion of Rebate Incentives for Expenses of Participating in a Turf Removal Water Conservation Program
12/31/18	17141.3	N/A	N/A	Exclusion of Reimbursement for Federal Taxes Imposed on Health Benefits for Same-Sex Spouses and Domestic Partners
12/31/18	18725 - 18729	N/A	N/A	Voluntary Contribution: California Fund for Senior Citizens
12/31/18	18851 - 18855	N/A	N/A	Voluntary Contribution: Emergency Food Assistance Program Fund
12/31/18	19551.1 & 19551.5	N/A	N/A	FTB Reciprocal Agreements with Cities and Counties for Tax Information

⁵⁴ In general, this is the last taxable year to which the provision applies. Fiscal years beginning within this taxable year are, in general, also covered by the provision. In some cases, the repeal date of the section is listed or the expiration applies to transactions occurring after this date.

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset	California Section	Federal Section	Federal Sunset	Description
06/30/19	24330	N/A	N/A	Exclusion of Income Received from Managed Care Organization
12/31/19	17144.7	N/A	N/A	Student Loan Forgiveness Debt Relief
12/31/19	18761 - 18766	N/A	N/A	Voluntary Contribution: California Alzheimer's Disease and Related Research Fund
06/30/20	17053.30 - 23630	N/A	N/A	Natural Heritage Preservation Credit
12/31/20	17053.73 & 23626	N/A	N/A	New Employment Credit ⁵⁵
12/31/20	17053.73 & 23626	N/A	N/A	New Employment Credit ⁵⁶
12/31/20	18754 - 18754.3	N/A	N/A	Voluntary Contribution: California Sea Otter Fund
12/31/20	18801 - 18804	N/A	N/A	Voluntary Contribution: California Firefighters' Memorial Fund
12/31/20	18805 - 18808	N/A	N/A	Voluntary Contribution: California Peace Officer Memorial Foundation Fund
12/31/20	18900.20 - 18900.26	N/A	N/A	Voluntary Contribution: Habitat for Humanity Fund
12/31/21	17053.88.5- 23688.5	N/A	N/A	Agricultural Donations to a Food Bank Credit
12/31/21	18901 - 18901.3	N/A	N/A	Voluntary Contribution: Prevention of Animal Homelessness and Cruelty Fund

⁵⁵ The new employment credit law sections (R&TC sections 17053.73 and 23626) are repealed on December 1, 2024. Those law sections generally apply to taxable years beginning on or after January 1, 2014, and before January 1, 2021; however, they continue to be operative for taxable years beginning on or after January 1, 2021, but only with respect to qualified full-time employees who commence employment with a qualified taxpayer in a designated census tract or former enterprise zone in a taxable year beginning before January 1, 2021.

⁵⁶ The new employment law sections (R&TC sections 17053.73 and 23626) are repealed on December 1, 2024. Those law sections generally apply to taxable years beginning on or after January 1, 2014, and before January 1, 2021; however, they continue to be operative for taxable years beginning on or after January 1, 2021, but only with respect to qualified full-time employees who commence employment with a qualified taxpayer in a designated census tract or former enterprise zone in a taxable year beginning before January 1, 2021.

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset	California Section	Federal Section	Federal Sunset	Description
12/31/22	18706	N/A	N/A	Voluntary Contribution: Special Olympics Fund
12/31/22	18711	N/A	N/A	Voluntary Contribution: California Domestic Violence Fund
12/31/22	18735	N/A	N/A	Voluntary Contribution: Revive the Salton Sea Fund
12/31/22	18781	N/A	N/A	Voluntary Contribution: Type 1 Diabetes Research Fund
12/31/22	18897	N/A	N/A	Voluntary Contribution: School Supplies for Homeless Children Fund
12/31/23	17207.14 & 24347.14	N/A	N/A	Automatic Disaster Loss Treatment for Areas Proclaimed by the Governor to Be in a State of Emergency
12/31/24	17059.2 & 23689	N/A	N/A	California Competes Tax Credit
12/31/30	23636	N/A	N/A	New Advanced Strategic Aircraft Credit

EXHIBIT C – REVENUE TABLES

Assumed Enactment after June 30, 2017

Table 1 – Trade Facilitation and Trade Enforcement Act of 2015
(Public Law 114-125)

Act Section	Provision	2016-17	2017-18	2018-19	2019-20
921	Increase in Penalty for Failure to File Return of Tax	\$800,000	\$3,500,000	\$2,800,000	\$2,800,000

Table 2 – United States Appreciation for Olympians and Paralympians Act of 2016
(Public Law 114-239)

Act Section	Provision	2016-17	2017-18	2018-19	2019-20
2	Olympic and Paralympic Medals and 7 USOC Prize Money Excluded from Gross Income	\$0	- < \$10,000	- < \$10,000	- \$50,000

Table 3 – 21st Century Cures Act
(Public Law 114-255)

Act Section	Provision	2016-17	2017-18	2018-19	2019-20
18001	Exception from Group Health Plan Requirements for Qualified Small Employer Health Reimbursement Arrangements	\$0	-\$2,400,000	-\$3,500,000	-\$1,100,000

Table 4 – Combat-Injured Veterans Tax Fairness Act of 2016
(Public Law 114-292)

Act Section	Provision	2016-17	2017-18	2018-19	2019-20
3	Restoration of Amounts Improperly Withheld for Tax Purposes from Severance Payments to Veterans with Combat-Related Injuries	Baseline	Baseline	Baseline	Baseline