Franchise Tax Board **ANALYSIS OF ORIGINAL BILL**

Author:	Acosta, et al.	Analyst:	Jessica Deitchman	Bill Number:	AB 782
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 15, 2017
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Medical Care Expense Deduction/California Health Insurance Fairness Act

SUMMARY

This bill would, under the Personal Income Tax Law, recast the itemized deductions for certain medical expenses as a deduction from gross income.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

The reason for the bill is to level the playing field for individuals who are not employed by large companies by allowing them to fully deduct medical insurance premiums, and is intended specifically as a means to address the increased costs on individuals who are affected by the Affordable Care Act.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2017.

FEDERAL/STATE LAW

Deductions From Gross Income

Existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating adjusted gross income (AGI), such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self-employed individuals, retirement savings, and alimony. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as above-the-line deductions.

Itemized Deductions – Unreimbursed Medical Expenses

Expenses deductible as unreimbursed medical expenses are amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or transportation primarily for and essential to such medical care, for amounts paid for medical insurance that covers such medical care (including essential transportation and amounts paid as premiums for Medicare Part B supplemental medical insurance), and for long-term-care services.

California conforms to the federal itemized deduction for unreimbursed medical expenses, modified to provide an AGI threshold of 7.5 percent.[1]

THIS BILL

This bill would, for taxable years beginning on or after January 1, 2017, allow a deduction in computing an individual's AGI for the amounts paid during the taxable year to purchase medical care insurance, or to pay for transportation primarily for and essential to such medical care. Medical care insurance would generally mean medical care insurance as described in IRC section 213(d)(1)(D), except that it would not include Medicare Part B supplemental medical insurance or insurance for long-term care services. In other words, medical care insurance would generally mean amounts paid for an insurance plan that covers the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body.

No itemized deduction would be allowed for any amount included as a deduction from gross income allowed by this bill.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 1831 (Conway, 2013/2014) similar to this bill, would have allowed individuals to deduct certain medical insurance premiums and medical transportation expenses. AB 1831 failed to pass out of the Assembly by the constitutional deadline.

OTHER STATES' INFORMATION

The states surveyed include*, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to *California's* economy, business entity types, and tax laws. A review of these states' laws found that *Massachusetts*, *Minnesota*, and *New York* allow the same itemized deduction for medical expenses, including medical insurance premiums, that is allowed under federal law. *Illinois* and *Michigan* do not allow itemized deductions, and do not allow individuals to deduct medical expenses.

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[1] Under Revenue and Taxation Code (R&TC) section 17201, California conforms to IRC section 213, relating to medical, dental, etc., expenses, as of the "specified date" of January 1, 2015, with a modification under R&TC section 17241 that, for tax years beginning on or January 1, 2015, the medical-expense deduction federal AGI threshold was reduced from 10 percent to 7.5 for California income tax purposes.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 782 As Introduced February 15, 2017 Assumed Enactment After June 30, 2017 ($ in Millions)		
2017-18	2018-19	2019-20
- $550	- $380	- $400

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

Revenue Discussion

Using data from Covered California, the Kaiser Family Foundation, and the Franchise Tax Board's Personal Income Tax microsimulation model, it is estimated that California taxpayers spent approximately $9 billion on out-of-pocket qualified medical insurance premiums and medical transportation expenses in taxable year 2014. It is estimated that 40 percent of these expenses are associated with taxpayers who receive federal insurance subsidies bringing the total qualified out-of-pocket expense down to $5.4 billion. Applying an average tax rate of 5 percent, results in an estimated revenue loss of $270 million in taxable year 2014. This amount was grown to reflect changes in the insurance industry over time, resulting in an estimated revenue loss of $340 million in taxable years 2017.

The tax-year estimates are converted to fiscal-year estimates, and then rounded to arrive at the estimates shown in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Those in support of this bill may argue that it would provide parity between individuals who have employer-provided medical insurance and those who purchase medical insurance with after-tax dollars.

Opponents: Those in opposition to this bill may argue that it should be expanded to allow individuals to deduct all medical expenses.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov