



Bill Analysis

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Sponsor:

Bill Number: AB 2384

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Introduced: February 18, 2020

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Related Bills: See Legislative
History

SUBJECT

Health Savings Accounts

SUMMARY

This bill would in modified conformity to federal law, allow a deduction in computing adjusted gross income (AGI) relating to Health Savings Accounts (HSA), as well as provide conformity to allowance of rollovers from specified accounts as is allowed on a federal individual income tax return.

This analysis only addresses the provisions that would impact the department.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to motivate California families to open and contribute to a health savings account thereby encouraging more Californians to pursue a means of preparing for future health-related expenses.

ANALYSIS

This bill, under the Personal Income Tax Law, would allow a deduction in computing AGI relating to an HSA as is allowed on a federal individual income tax return.

For taxable years beginning on or after January 1, 2020, and before January 1, 2025, the following items would be specifically excluded from gross income:

- Contributions to an HSA.
- Contributions on behalf of an employee to cafeteria plans, and health savings accounts.
- Rollovers from medical savings accounts to health savings accounts.

Unlike federal law, this bill would not impose an additional tax for distributions used for nonqualified medical expenses.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

Federal/State Law

Federal Law

Under federal law, eligible individuals may establish an HSA, which provides tax-favored treatment for current medical expenses, as well as the ability to save on a tax-favored basis for future medical expenses. An HSA is a tax-exempt trust or custodial account created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. Generally, individuals are eligible to establish an HSA when they are covered by a high-deductible health plan (High Deductible Plan) and have no other health coverage (with the exception of plans providing certain permitted benefits/coverage).

Within limits, contributions to an HSA made by, or on behalf of, an eligible individual are deductible by the individual in determining adjusted gross income (AGI). Contributions to an HSA are excludable from income and employment taxes if made by the employer. Earnings on amounts in HSAs are not taxable. Distributions from an HSA for qualified medical expenses are not includible in gross income; however, distributions made from an HSA that are used for non-qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20 percent additional tax is inapplicable if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

Generally, an employer's contribution to an HSA on behalf of an employee must be the same amount or percent for all comparable participating employees with the same level of coverage (self-only or family coverage). For purposes of making contributions to HSAs of non-highly compensated employees, highly compensated employees are not treated as comparable participating employees, thus employers are permitted, but not required, to make larger contributions to HSAs of non-highly compensated employees than the employer makes to the HSAs of highly compensated employees. However, employer contributions to the HSAs of highly compensated employees may not exceed employer contributions to the HSAs of non-highly compensated employees.

A taxpayer is allowed to make a one-time contribution to an HSA of amounts distributed from an individual retirement arrangement (IRA). The contribution must be made in a direct trustee-to-trustee transfer. Amounts distributed from an IRA under these rules are not includible in income to the extent that the distribution would otherwise be includible in income. In addition, such distributions are not subject to the 10 percent additional tax on early distributions.

State Law

California law has no provisions comparable to the federal HSA provisions. As a result, a taxpayer must reverse the federal treatment of deductions, interest, and contributions related to their HSA on their California income tax return.

Although California has not conformed to HSAs, California law does conform to the federal rules for Medical Savings Accounts (MSAs), and allows a deduction equal to the amount deducted on the federal return for the same taxable year. California imposes a 12.5 percent additional tax rather than the 20 percent additional federal tax on distributions from an MSA used for non-qualified medical expenses.

Because a tax-free rollover from an MSA to an HSA is unavailable under California law, any distribution from an MSA that is rolled into an HSA must be added to AGI on the taxpayer's California return; and, the distribution is subject to the MSA 12.5 percent additional tax, treated as being made for a purpose other than a qualified medical expenses.

Additionally, a tax-free qualified HSA funding distribution is unavailable under California law because California specifically does not conform to Internal Revenue Code (IRC) section 223, relating to HSAs, even though California conforms to IRC section 408, relating to IRAs. Any distribution from an IRA to an HSA must be added to AGI on the taxpayer's California return and would be subject to a 2.5 percent additional tax under the rules for premature distributions.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Taxpayers that receive nonqualified distributions from an HSA on or after January 1, 2020, where nondeductible contributions had been made prior to January 1, 2020, could be considered to be taxed twice on the same income, because the bill requires nonqualified distributions to be fully included in taxable income. A remedy to consider is a partial exclusion of nonqualified distributions for state tax purposes to the extent that contributions were previously nondeductible from California gross income.

Technical Considerations

Subdivision (d) of Section 17072 would conform to IRC Section 62(a)(19) "as modified by Section 17217". Because Section 17217 refers to IRC Section 223 as opposed to IRC Section 62(a)(19), the phrase "as modified by Section 17217" should be deleted.

Policy Concerns

This bill would allow preferential tax treatment for specified contributions to health savings accounts similar to federal law. Unlike federal law, this bill lacks an additional tax on nonqualified distributions from these tax preferred accounts that serves as a disincentive to use distributions for anything other than qualifying expenses.

LEGISLATIVE HISTORY

AB 989 (Cooper, 2017/2018) would have allowed the same deduction on a California personal income tax return for contributions to a Health Savings Account (HSA) as is allowed on a federal individual income tax return for the same taxable year. AB 989 failed to pass out of the Assembly by the constitutional deadline.

AB 1140 (Oberholte, 2017/2018), similar to this bill, would conform California personal income tax law to the federal HSA deduction rules. AB 1140 failed to pass from the Assembly by the constitutional deadline.

AB 1129 (Gaines, 2013/2014), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. AB 1129 failed to pass from the Assembly by the constitutional deadline.

AB 854 (Garrick, 2011/2012), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. AB 854 failed to pass from the Assembly by the constitutional deadline.

AB 326 (Garrick, 2009/2010), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. AB 326 failed to pass from the Assembly by the constitutional deadline.

SB 353 (Dutton, 2009/2010), a similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. SB 353 failed to pass from the Senate by the constitutional deadline.

SB 1262 (Aanestad, 2009/2010), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. SB 1262 failed to pass from the Senate by the constitutional deadline.

SBX6 13 (Dutton, 2009/2010), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. SBX6 13 failed to pass from the Senate by the constitutional deadline.

SBX8 47 (Dutton, 2009/2010), similar to this bill, would have conformed California personal income tax law to the federal HSA deduction rules. SBX8 47 failed to pass from the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

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.

ECONOMIC IMPACT

The bill states that for purposes of Section 41, the goal, purpose, and objective of this credit is to encourage Californians to contribute to health savings accounts and save in preparation for future health-related expenses, reduce health-related debt on a dollar-for-dollar basis, and bring California into conformity with federal tax law.

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2384 as Introduced on February 18, 2020.
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$110
2021-2022	-\$90
2022-2023	-\$100

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Using FTB data it was determined that California taxpayers contributed \$450 million to Health Savings Accounts (HSAs) in 2017. This amount was grown to reflect changes in the economy over time, resulting in an estimated \$600 million HSA deduction in taxable year 2020. It is estimated that employer contributions, on behalf of employees, would increase contributions by 25 percent bringing the total deduction to \$750 million. Applying a marginal tax rate of 9 percent, the estimated revenue loss for 2020 would be approximately \$70 million.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

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