

DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: June 29, 2011
POSITION: Oppose

BILL NUMBER: AB 242
AUTHOR: Assembly Revenue and Taxation

SPONSOR: BOE

BILL SUMMARY: Taxes: PIT Health Conformity: Sales Tax Administration

This bill would (1) conform to five federal health-care reform provisions of the 2010 Patient Protection and Affordable Care Act (PPACA) and Health Care and Education Reconciliation Act (HCERA), and (2) implement several Board of Equalization (BOE) technical and housekeeping provisions, along with a provision to provide the BOE and the State Controller’s Office with express authority to collect orders of restitution awarded to the BOE in criminal proceedings in the same manner as tax liabilities.

FISCAL SUMMARY

Revenue: the Franchise Tax Board (FTB) estimates that the conformity provisions in this bill would result in revenue losses of \$1.95 million in 2010-11, \$1.85 million in 2011-12, and \$430,000 in 2012-13 and 2013-14. The BOE expects to collect an additional \$1.14 million annually due to the restitution provision of this bill.

The net revenue impact of this bill is a loss of \$1.95 million in 2010-11 and \$710,000 in 2011-12, followed by gains of \$710,000 in 2012-13 and 2013-14. (See “Fiscal Analysis” for a breakdown by provision)

Costs: This bill is not expected to significantly impact the FTB’s costs. The BOE will incur one-time costs of \$106,000 to modify existing computer systems to incorporate orders of restitution to taxpayer accounts.

COMMENTS

The Department of Finance is opposed to this bill due to the revenue loss from the conformity provisions as well as one time implementation costs to the BOE. Finance notes that from a policy perspective, conformity with federal tax law has the benefit of reducing complexity in tax preparation and administration, however, the impact on the General Fund must also be considered.

This bill also encompasses BOE’s annual omnibus bill and contains several non-controversial technical and housekeeping provisions, along with a provision to streamline collection on orders of restitution, which are estimated to increase revenues by about \$1 million annually beginning in 2011-12. Although the BOE restitution provision partially offsets the revenue loss due to the conformity provisions, there is still a near term net revenue loss to the General Fund.

Analyst/Principal (0723) C. Angaretis	Date	Program Budget Manager Mark Hill	Date
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Department Deputy Director	Date
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Governor’s Office:	By:	Date:	Position Approved _____
			Position Disapproved _____

BILL ANALYSIS Form DF-43 (Rev 03/95 Buff)

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ANALYSIS

A. Programmatic Analysis

(1) Federal Health-Care Conformity:***Background:***

The PPACA and the HCERA were enacted in March 2010 to effectuate fundamental reforms to the United States health-care system. A universal-coverage requirement begins in 2014, when almost all individuals not covered by Medicaid or Medicare will be required to obtain health-care coverage or pay penalties. Lower-income individuals, as well as some middle-class families, will receive a credit or voucher to help pay for health insurance, which can be used at one of the American Health Benefits Exchanges that are required to be established by every state. Employers electing not to offer qualifying coverage will be subject to an additional tax to help finance the health-care coverage for their employees. Exceptions will be made for small businesses.

Health Care Conformity Provisions***a) Student Loan Repayment Program***

Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.

The new federal health care laws modify the gross income exclusion for amounts received under the National Health Service Corps loan repayment program and certain state loan repayment programs to include any amount received by an individual under any state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas. Under the PPACA, for taxable years beginning on or after January 1, 2010, individuals are allowed to exclude from income certain payments received under the National Health Service Corps loan repayment or forgiveness programs.

This bill would exclude from income, for taxable years beginning on or after January 1, 2010, certain payments received by an individual taxpayer under the National Health Service Corps loan repayment or forgiveness programs.

The FTB estimates that this provision would result in revenue losses of \$400,000 in 2010-11, \$500,000 in 2011-12, \$350,000 in 2012-13, and \$350,000 in 2013-14.

b) Adoption Assistance Exclusion

Under federal tax law, an employee may exclude from their gross income qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program. The PPACA increased the amount of qualified adoption expenses excludable from gross income from \$12,170 to \$13,170, for taxable years beginning on or after January 1, 2010. This provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was originally due to sunset on December 31, 2010, but was delayed by the PPACA until December 31, 2011.

Current state law, for taxable years beginning on or after January 1, 2010, conforms to the federal tax exclusion for qualified adoption expenses paid or reimbursed by an employer under an adoption

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assistance program as of the specified date of January 1, 2009. Current state law also automatically conforms to the PPACA sunset extension. However, California does not conform to the \$1,000 adoption expense exclusion increase.

This bill would increase, for taxable years beginning on or after January 1, 2010, the amount of qualified adoption expenses excludable from an employee's gross income by \$1,000.

The FTB estimates that this provision would result in revenue losses of \$1.5 million in 2010-11 and \$1.2 million in 2011-12.

c) Health Care Benefits of Indian Tribe Members

Under the PPACA, qualified health care benefits provided to a member of an Indian tribe, the member's spouse, or the member's dependents are excludable from the member's gross income, for benefits and coverage provided after March 30, 2010. The exclusion applies to the value of the following:

- Health services or benefits provided or purchased by the Indian Health Service (IHS) through a grant to or a contract or compact with an Indian tribe or tribal organization, or through programs of third parties funded by the IHS;
- Medical care provided by an Indian tribe or tribal organization to a member of an Indian tribe, including the member's spouse or dependents;
- Accident or health plan coverage provided by an Indian tribe or tribal organization for medical care to a member of an Indian tribe, including the member's spouse or dependents; and
- Any other medical care provided by an Indian tribe or tribal organization that supplements, replaces, or substitutes for the programs and services provided by the federal government to Indian tribes or Indians.

Current state law conforms to the general federal welfare doctrine and the exclusion of certain health care benefits from gross income. Current law also exempts from taxation income received by an Indian tribal member who lives in that tribe's Indian country and such income is sourced in the tribal member's Indian country.

This bill excludes from income certain qualified health care benefits provided after March 30, 2010, to a member of an Indian tribe, the member's spouse, or the member's dependents.

The FTB estimates that this provision would result in revenue losses of \$50,000 in 2010-11, \$150,000 in 2011-12, \$80,000 in 2012-13, and \$80,000 in 2013-14.

d) Establishment of Simple Cafeteria Plans for Small Businesses

Under existing law, an employer may establish a "cafeteria plan", a separate written plan under which all participants are employees and are permitted to choose among at least one taxable benefit (e.g., current cash compensation) and at least one "qualified benefit". "Qualified benefits" are employer-provided benefits that are not taxable, such as, for example, group term life insurance coverage not in excess of \$50,000 and benefits under a dependent care assistance program. Cafeteria plans and certain qualified benefits are subject to non-discrimination requirements. The basic purpose of those requirements is to prevent the provision of disproportionate benefits to highly-compensated employees. A failure to satisfy the nondiscrimination rules, generally, results in a loss of the tax exclusion by the highly-compensated individuals.

Under federal law, for taxable years beginning on or after January 1, 2011, the PPACA allows certain small employers to provide a simple cafeteria plan for their employees, under which the

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nondiscrimination rules of a classic cafeteria plan would be treated as satisfied. A small business is an employer that, during either of the two preceding years, employed an average of 100 or fewer employees on business days.

This bill would conform California's income tax law to the federal change under the PPACA to provide small employers a safe harbor from the nondiscrimination requirements of a cafeteria plan. The safe harbor would apply to taxable years beginning on or after January 1, 2011.

The FTB estimates that this provision would result in a negligible loss of revenues.

e) Offering of Exchange-Participating Qualified Health Plans Through Cafeteria Plans

Under federal law, for taxable years beginning after December 31, 2013, reimbursement or direct payments for the premiums for coverage under any qualified health plan offered through an exchange is a qualified benefit under a cafeteria plan if the employer is a qualified employer. "Qualified benefits" are employer-provided benefits that are not taxable. A qualified employer, generally, is a small employer that elects to make all its full-time employees eligible for one or more qualified plans offered in the small group market through an exchange.

This bill would conform California's tax laws to the federal definition of "qualified benefits" to include reimbursement and direct payments for the premiums for qualified health plan offered through an exchange under a qualified employer's cafeteria plan. This bill would allow small employers to offer exchange-participating health plans through cafeteria plans effective in January 1, 2014.

The FTB estimates that this provision would result in a negligible loss of revenues.

(2) BOE Omnibus Provisions:

a) Lemon Law: Use Tax Reimbursement

Under current law, California's "Lemon Law" requires a car manufacturer to make restitution in an amount equal to the actual price paid for the vehicle, including sales tax. The law further requires the BOE to reimburse the manufacturer for the amount equal to the sales tax included in the restitution. The "Lemon Law" is silent with regard to restitution involving use tax.

This bill would allow the BOE to reimburse the manufacturer of a new car for the use tax that was refunded to a buyer or lessee when the car is reacquired by the manufacturer under California's Lemon Law.

Discussion

In a court case from 2008 a judge ruled that the use tax should not be treated differently than the sales tax in "Lemon Law" restitution cases. This provision fixes the law to conform to the judge's decision.

b) Bad Debt Election From Requirement Repeal

Under current law, a retailer can be relieved of the sales and use tax liability when the measure of tax is related to amounts that have been charged off for income tax purposes. Further, retailers who sell their receivables or lenders that purchase them can claim a refund or deduction attributable to the portion of the receivable that is written off or worthless. In these cases, the retailer and lender must file an election form that designates which party is entitled to the claim from the bad debt loss.

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This bill would remove the requirement to file that election form with the BOE and instead keep it in-house.

Discussion

According to the BOE, these election forms have not provided any assistance in administering this program over the last ten years.

c) Vehicles Purchased Outside California

Under current law, there is rebuttable presumption that vehicles, vessels, or aircraft brought into the state within 12 months of purchase are for use in this state and thus subject to use tax. However, the law provides an exception for vehicles, vessels, or aircraft brought into the state for repair, retrofit, or modification (RRM) to be conducted by a repair facility licensed to do business **by the county** in which it is located.

This bill would make a technical clarification to the RRM exception to state that the RRM be conducted by a repair facility licensed to do business **by the county, city, or city and county** in which it is located.

Discussion

This change in terminology is simply to reflect the reality that business licenses can sometimes be issued by a city in which the business is located, rather than just the county.

d) Claim for Bank Charge Reimbursement

Under current law, the BOE is authorized to seize property of a delinquent taxpayer and to issue an order to specified financial institutions to obtain property to satisfy tax obligations.

Under current law, if the BOE issues a levy notice to withhold in error, and this error results in bank charges or third-party check charges, the taxpayer can file a claim to have those charges refunded. Current law does not provide the same relief when the BOE error was not technically a result of a BOE levy or notice to withhold.

This bill would provide that a taxpayer can file a claim for refund for bank or third-party check charges due to a BOE processing or collection error.

Discussion

This provision is intended to provide refunds to taxpayers that incur bank charges solely as the result of BOE error and through no fault of the taxpayer. This is consistent with current law and is intended to be fair to taxpayers that are the victim of BOE error that was not directly the result of a notice to withhold or a BOE levy.

e) Orders of Restitution

Under current law, the BOE is authorized to issue levies, file liens, or issue a notification to withhold earnings in order to collect delinquent liabilities, including tax, interest, and penalties. The State Controller's Office (SCO) also has this same authority in regard to collections that the office administers under the Motor Vehicle Fuel Tax Law.

Under current law, the BOE and SCO do not have the same authority with regard to collections for an order of restitution, since an order of restitution is not a tax or a tax penalty.

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This bill would provide the BOE and the SCO with express authority to collect orders of restitution awarded to the BOE in criminal proceedings in the same manner as tax liabilities.

Discussion

Finance notes that the Franchise Tax Board (FTB) was granted similar authority for improving collections of restitution orders, per AB 1530 (Statutes of 2010, Chapter 359), in the 2010 Legislative session. Current collection procedures for restitution orders seem cumbersome, and this change would streamline the collection process.

DISCUSSION:

Finance notes that prior to passage of Proposition 26 in November 2010, significant conformity legislation typically bundled numerous provisions into one bill that was, on net, revenue neutral. This would mitigate the negative impact on the General Fund and could also be passed by a majority vote. Since passage of Proposition 26, however, a revenue neutral conformity bill is no longer an option. Proposition 26 would require a 2/3 vote for any conformity tax increase whereas conformity legislation that does not include any tax increases would still require only a simple majority to pass.

Although this bill results in estimated revenue increases, on net, beginning in 2012-13, this is due to the expected increase in BOE collections from the Orders of Restitution provision, not from tax increases requiring a 2/3 vote.

B. Fiscal Analysis

The health care conformity and omnibus provisions of this bill would result in the following revenue impact:

(Dollars in millions)				
Revenue Impact Provisions:	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>
<i>Health Care Conformity:</i>				
1. Student Loan Repayment Program	-0.40	-0.50	-0.35	-0.35
2. Adoption Assistance Exclusion	-1.50	-1.20	0.00	0.00
3. Health Care Benefits of Indian Tribe Members	-0.05	-0.15	-0.08	-0.08
4. Establishment of Simple Cafeteria Plans for Small Businesses	0.00	0.00	0.00	0.00
5. Offering of Exchange-Participating Qualified Health Plans Through Cafeteria Plans	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
<i>Conformity Total:</i>	-1.95	-1.85	-0.43	-0.43
<i>BOE Omnibus:</i>				
Orders of Restitution	0.00	1.14	1.14	1.14
<i>AB 242 Net Revenue Impact:</i>	-1.95*	-0.71	0.71	0.71

* The 2010-11 revenue loss is due to changes to the 2010 tax year and would be accrued.

Costs: This bill is not expected to significantly impact the FTB's costs. The BOE will incur one-time costs of \$106,000.

BILL ANALYSIS/ENROLLED BILL REPORT--(CONTINUED)

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Code/Department Agency or Revenue Type	SO	(Fiscal Impact by Fiscal Year)								
	LA	(Dollars in Thousands)								
	CO	PROP							Fund	
	RV	98	FC	2011-2012	FC	2012-2013	FC	2013-2014	Code	
1147/Pers Inc Tax	RV	Yes	U	-\$1,950	U	-\$710	U	\$710	0001	
1730/FTB	SO	No		----- No/Minor Fiscal Impact -----						0001
1100/Majr Tax Lic	RV	No	U	\$1,140	U	\$1,140	U	\$1,140	0001	
0860/Equalization	SO	No	C	\$106		--		--	0001	