State of Wisconsin

LEGISLATIVE REFERENCE BUREAU

1 EAST MAIN, SUITE 200
P. O. BOX 2037
MADISON, WI 53701-2037

LEGAL SECTION: (608) 266-3561
REFERENCE SECTION: (608) 266-0341
FAX: (608) 264-6948

STEPHEN R. MILLER
CHIEF

February 17, 2010

MEMORANDUM

To: Senator Kreitlow

From: Marc E. Shovers, Managing Attorney, (608) 266–0129

Subject: Technical Memorandum to **2009 SB 425** (LRB–3219/2) **by DOR**

We received the attached technical memorandum relating to your bill. This copy is for your information and your file.

If you wish to discuss this memorandum or the necessity of revising your bill or preparing an amendment, please contact me.

MEMORANDUM

December 17, 2009

TO: Marc Shovers
Legislative Reference Bureau

FROM: Rebecca Boldt
Department of Revenue

SUBJECT: Technical Memorandum on Senate Bill 425 (LRB 3219/2) – Health Savings Accounts

The Department has the following concerns related to the bill:

Allowing a credit for Health Savings Accounts (HSAs) instead of following federal law and allowing a deduction for such accounts adds a great deal of complexity for the taxpayer. Following federal law would mean that the taxpayer would need no further adjustment for Wisconsin. Allowing the credit instead of a deduction means the taxpayer will have to add back the amount of the federal deduction, contact the financial institution to determine the earnings on the account and add the earnings to Wisconsin income, and then compute the credit. Distributions from the account are not allowed as a medical deduction for federal purposes but would be allowed for Wisconsin. Not following federal law is also a problem for taxpayers who want to rollover an amount from a medical savings account (MSA) to a HSA. The rollover amount becomes taxable for Wisconsin.

The meaning of "federal tax-exempt earnings" in sec. 71.07(6f)(a)1 and 2 is unclear. For federal purposes, an employer may contribute to a HSA for an employee. The amount contributed is not included in the employee's wages for federal tax purposes, but would be included for Wisconsin. In addition, the earnings on a HSA are exempt from federal tax, but taxable for Wisconsin. Does "federal tax-exempt earnings" mean the amount not included as wages for federal tax purposes as provided in sec. 106(d) of the IRC or the amount of tax-exempt earnings from the investment of the account? This should be clarified.

Because Wisconsin does not recognize HSAs, amounts withdrawn from HSAs for payment of medical expenses are not allowed as itemized deductions for federal purposes but are allowed as itemized deductions for Wisconsin when computing the itemized deduction credit. Thus a person could receive a double benefit, first when the credit is allowed and again when the amounts are withdrawn to pay medical expenses.

For federal purposes, if amounts withdrawn from HSAs are used for nonmedical purposes, the amount must be included in income. There is no provision in this bill for those circumstances

where the amount withdrawn is not used for medical expenses. A person receives the credit but there are no consequences if the amount is not used for medical purposes.

The draft states that "poverty line" has the meaning given in s. 49.265(1)(c). This section defines "poverty line" to mean the nonfarm federal poverty line for the continental United States, as defined by the federal department of labor under 42 USC 9902(2). According to a Department of Health and Human Services Notice:

> Due to confusing legislative language dating back to 1972, the poverty guidelines have sometimes been mistakenly referred to as the "OMB" (Office of Management and Budget) poverty guidelines or poverty line. In fact, OMB has never issued the guidelines; the guidelines are issued each year by the Department of Health and Human Services. The poverty guidelines may be formally references as "the poverty guidelines updated periodically in the Federal Register by the U.S. Department of Health and Human Services under the authority of 42 U.S.C. 9902(2)."

Are these the guidelines to be used? They have not distinguished between farm and nonfarm since 1982. Clarification is needed.

The poverty guidelines are updated annually. To avoid confusion, the bill should specify that the poverty line for each calendar year is to be used.

The poverty guidelines are based in part on the number of persons in a family. This bill should include a definition of family size for the purpose of computing the poverty level. Is it all adults in a household or only married adults and dependent children, etc.? If two unmarried persons live together, is this two separate families? If the two unmarried persons also have a child, which parent includes the child as part of their family?

What income measure is compared to the poverty guidelines for this bill? The bill refers to adjusted gross income, but it is unclear whether it is intended to be federal adjusted gross income of Wisconsin adjusted gross income.

If you have any questions regarding this technical memorandum, please contact Brad Caruth at 608-261-8984 or Bradley.Caruth@revenue.wi.gov.

cc: Senator Kreitlow