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September 26, 2023

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 364: Federalize the Tax Treatment of Certain High Deductible Health Plans

Senate Bill 364 (SB 364) was introduced on July 13, 2023, and referred to the Senate Committee on Universities and Revenue. On August 21, 2023, Senate Amendment 1 (SA 1) was offered. The Committee held a public hearing on August 23, 2023, and an executive session on September 6, 2023, whereupon the bill as amended by SA 1 was recommended for passage on a vote of 8-0.

BACKGROUND

State individual income tax and corporate income/franchise tax provisions regarding the amount of income subject to taxation are generally referenced to definitions under federal law. The Department of Revenue (DOR) typically reviews the previous year's federal law changes each year and submits recommendations to the Legislature to update state references to the federal Internal Revenue Code (IRC). Under current law, state tax references generally refer to the IRC in effect on December 31, 2020.

Federal law allows taxpayers to create a health savings account (HSA) if they meet certain requirements, such as that the individual is covered under a high deductible health plan (HDHP) and cannot be claimed as a dependent on another individual's tax return. Contributions to an HSA by the employee and their employer, and the associated interest earnings, are excludable from gross income, as are account distributions if used to pay for qualified medical expenses.

The Consolidated Appropriations Act of 2022 (CAA22) provides that, for plan months beginning after March 31, 2022, and before January 1, 2023, a health plan may still be considered an HDHP even if it fails to require a deductible for telehealth and other remote care services. A subsequent federal act, the Consolidated Appropriations Act of 2023 (CAA23), extends this safe-harbor treatment to applicable HDHPs for plan years beginning after December 31, 2022, and before January 1, 2025. The CAA22 and CAA23 provisions extend a similar provision that was enacted for plan years beginning on or before December 31, 2021, under the federal Coronavirus Aid, Relief, and Economic Security Act of 2020, which was adopted for state tax purposes under 2019 Act 185.

SUMMARY OF SB 364, AS AMENDED BY SA 1

SB 364, as amended by SA 1, would adopt for state tax purposes the CAA22 and CAA23 provisions related to HDHPs, by specifying that Section 223(c) of the IRC in effect for federal purposes applies for state tax purposes, retroactive to tax year 2022.

In the absence of state adoption of these provisions, taxpayers who made contributions to and/or took distributions from an HSA account after March 31, 2022, and before January 1, 2025, for plans that did not require a deductible for telehealth or other remote care services would have to pay state tax on such amounts upon filing their state income tax return. Since state adoption of the CAA22 provision would apply retroactively, most affected state taxpayers would need to file an amended tax year 2022 return to receive the tax benefit, assuming taxpayers properly added back disqualified contributions and distributions when filing their tax year 2022 state income tax return.

Further, the bill as amended would provide that future federal law changes to Section 223(c) of the IRC (definitions and special rules governing HSA accounts) are automatically adopted for state tax purposes.

FISCAL EFFECT OF SB 364, AS AMENDED BY SA 1

DOR prepared a fiscal estimate for SB 364 on July 21, 2023, stating that the provisions are expected to reduce revenue by $1.4 million in 2023-24 and $0.6 million in 2024-25. However, this office has reestimated the fiscal effect to include the revenue reduction related to the retroactive effect of SB 364, as amended by SA 1. The bill is estimated to decrease individual income tax collections by $1.7 million in 2023-24, $0.7 million in 2024-25, and a minimal amount in 2025-26. The bill would automatically adopt any future federal law changes to definitions and special rules governing HSA accounts. The estimated fiscal effect of the bill would increase (or decrease) in response to future federal law changes.

DOR states that it began posting draft forms and instructions on September 15, 2023, and will print the individual income tax forms and instructions by October 15, 2023. If the bill is passed beyond this date, DOR states that it would have to reprint the relevant tax year 2023 forms and instructions, which would cause DOR to incur additional administrative costs. DOR also notes that, if the programming of forms and instructions cannot be completed within this time frame, the start of income tax filing season could be delayed, which may in turn delay taxpayers' ability to file their returns and claim any refunds for which they are eligible.

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