Bill Number: SJR 21 (Kehoe) as introduced on March 6, 2012

SUMMARY

Urges the federal government to allow all retirees who have contributed to a qualified retirement plan the option to use funds from their plan to pay for their medical and long term care premiums.

BOARD POSITION

Support. This measure promotes providing a benefit which would enhance members' financial security and improves the opportunity for members to save by permitting them to pay their medical or long term care premiums with tax free distributions.

REASON FOR THE BILL

Currently only qualified public safety officers may exclude from income the cost of health insurance. All retirees are affected by increasing healthcare costs which continue to outpace inflation.

ANALYSIS:

Existing Law:

The Pension Reform Act of 2006 permits the exclusion from gross income up to $3,000 annually in distributions from an eligible retirement plan directly to the specified carrier to pay premiums for health or long-term care insurance for a retired public safety officer, spouse and tax dependents. Currently, in order to be eligible to receive the tax benefit, a public safety officer retiree must have separated from service due to a disability or have attained normal retirement age. Although the benefit is extended to a spouse and dependents, the tax exclusion is no longer available to them in the event of the public safety member's death, even if the survivor is paid a survivor benefit.

This Bill:

Senate Joint Resolution (SJR) 21 urges the Congress of the United States and the President to amend the United States Internal Revenue Code to allow all retirees who have contributed to a qualified retirement plan, such as CalSTRS members, to exclude up to $3,000 annually from income taxation the amount paid to the retiree by the retirement system that the retiree uses to pay medical and long term care premiums. Currently, this tax benefit is extended solely to public safety officers who retire with a disability or attain normal retirement age. This resolution seeks to create parity among all workers by providing the same option afforded to public safety officers.

SJR 21 would provide all CalSTRS service and disability benefit recipients, regardless of age, or positive tax treatment with annual savings amounting to up to $750 in tax savings to a member with a marginal tax rate of 25 percent. The current 2012 IRS 1099-R guidance explicitly states that the taxable amount should not be reduced by any part of the $3,000 exclusion. As a result, CalSTRS would not be required to change any of its tax reporting procedures. Instead, the member would exclude as income the money paid as premiums.

Because CalSTRS already has a mechanism in place to make health and long-term care insurance payments on a member's behalf, implementation of federal legislation consistent with this resolution would require minor effort.

LEGISLATIVE HISTORY

SB 1552 (Gaines, 2012, Senate Governmental Finance Committee) conforms to the federal Internal Revenue Code with regard to qualified long-term care insurance, with certain exceptions. This bill would remove the exceptions, and would conform the Personal Income Tax Law to the federal income tax law with regard to qualified long-term care insurance, as provided.

AB 558 (Portantino, 2011, Held in Assembly Appropriations Committee) would have temporarily waived the 2.5% penalty otherwise imposed on early distributions from specified retirement savings plans, provided that the distributions are received by individuals who have exhausted their unemployment benefits.

AB 726 (Morrell, 2011, Held in Assembly Revenue and Taxation Committee) excluded from gross income amounts distributed out of a 401(k) plan to an individual if the entire amount does not exceed $100,000 and is paid into a health savings account (HSA) within 60 days. Specifically, this bill: Waives the 2.5% tax penalty for early 401(k) distributions that are excluded from gross income under this bill.

SB 401 (Wolk, Chapter 14, Statutes of 2010) generally conforms California personal income tax, corporation tax, and administration of franchise and income tax laws to federal income tax laws as set forth in the Internal Revenue Code as of January 1, 2009. This bill is substantially similar to SBX8 32 (Wolk) which was vetoed. Waiver of the early withdrawal penalty for distributions made from a governmental plan to a qualified public safety employee and penalty-free withdrawals from retirement plans for individuals called to active duty.

PROGRAM BACKGROUND

Current administrators, such as CalPERS (which pay retirement benefits to public safety employees), pay the premiums directly to the insurance provider, on behalf of the retiree, from his or her retirement or disability benefit. The eligible retired public safety officer reports the excluded funds on IRS Form 1040 when filing his or her annual income tax return. The public retirement systems are free to limit the providers to which they will pay directly.

Although CalSTRS does not provide health insurance coverage, each district has its own health insurance policies, and coverage may be part of each member's contract. Current law requires school districts, community colleges and county offices of education to offer retiring CalSTRS members and their spouses or registered domestic partners the opportunity to continue their medical and dental insurance at their own cost. However, CalSTRS will deduct premiums for medical insurance, as well as Medicare, if a request to do so is received from a CalSTRS retired member. Members can voluntarily have premiums and dues removed from their benefit payments and remitted directly to qualified insurance providers that have an agreement with CalSTRS. These payments are included on the member's Form 1099-R as gross income.

FISCAL IMPACT

Program Cost – None.

Administrative Costs/Savings – None.

SUPPORT

None known.

OPPOSITION

None known.

ARGUMENTS

Pro: Urges the United States Congress and the President to allow all retirees who have contributed to a qualified retirement plan the option to use funds from their plan to pay for their medical and long term care premiums.

Con: None.

LEGISLATIVE STAFF CONTACT

Melissa M. Gear
Legislative Advocate,
CalSTRS Legislative Affairs,
(916) 414-1982
mgear@calstrs.com

Mary Anne Ashley
Acting Director,
CalSTRS Governmental Affairs and Program Analysis,
(916) 414-1981
mashley@calstrs.com