

**DEPARTMENT OF TAXATION
2024 Fiscal Impact Statement**

1. **Patron** Phillip A. Scott

2. **Bill Number** HB 1160

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Portable Benefit Accounts Tax Credit.

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would authorize a Virginia resident who has worked as an independent contractor to establish a portable benefit account. Under the bill, a portable benefit account offered through and administered by a bank, credit union, or other depository institution and distributions from the account would be permitted to be used for the payment of various health-related costs. The bill would establish a nonrefundable tax credit for Taxable Years 2024 through 2028 for individuals who contribute to a portable benefit account.

This bill would be effective for taxable years beginning on and after January 1, 2024, and before January 1, 2029.

6. Budget amendment necessary: Yes.

Item(s): 258, Revenue Administration Services

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

7a. Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2024-25	\$94,026	1	GF
2025-26	\$92,327	1	GF
2026-27	\$95,206	1	GF
2027-28	\$97,209	1	GF
2028-29	\$99,336	1	GF
2029-30	\$101,464	1	GF

8. Fiscal implications:

Administrative Costs

The Department of Taxation (“the Department”) would incur costs of \$94,026 for FY 2025, \$92,327 for FY 2026, \$95,206 for FY 2027, \$97,209 for FY 2028, \$99,336 for FY 2029, and \$101,464 for FY 2030, which would include one full-time employee to verify credit eligibility. These costs assume that the bill would be amended to limit eligibility to information on the taxpayer’s return. A technical amendment is suggested on Line 10 to limit the credit to

information on the taxpayer's return. If the bill is enacted as introduced, incorporating the returns of all individuals in a household of the taxpayer claiming the credit, the Department's administrative costs would be higher.

Revenue Impact

This bill would result in an unknown, but potentially significant revenue loss beginning in Fiscal Year 2025. Reliable data does not exist for the number of independent contractors in Virginia. Moreover, it is unknown how many of those independent contractors would contribute to a portable benefit account or the amount of their contributions.

Contributions would not be limited to earnings from work as an independent contractor. As a result, an individual with substantial earnings from employment or investments could do minimal work as an independent contractor and then contribute enough funds to a portable benefit account to offset his entire Virginia tax liability for that taxable year. To the extent this is permissible under this bill, this could increase the potential negative revenue impact. A technical amendment is suggested on Line 10 to limit the credit to the amount earned as an independent contractor.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

Since the tax credit is nonrefundable, the allowance of the credit cannot consider the tax liability of dependents and other members of the household whose income and tax liability are not included on the taxpayer's return. "Taxpayer" would include the spouse if a joint return is filed. The following technical amendments are suggest

Line 54 at the beginning of the line
Strike: household's
Insert: taxpayer's

Line 55 after "exceeds the"
Strike: household's
Insert: taxpayer's

Line 57 after "liability of the"
Strike household
Insert taxpayer

If it is desired to limit the amount of the credit to earnings as an independent contractor, the following amendment is suggested.

Line 62, after "claimed"
Insert: and shall be limited to the taxpayer's earnings as an independent contractor for the taxable year

11. Other comments:

Background

The Internal Revenue Service (“IRS”) has published guidance regarding whether a worker should be classified as an independent contractor. The IRS guidelines follow the common law rules, which generally focus on the extent to which the person for whom services are performed has the right to control and direct the individual who performs the services. For many years, the IRS looked at 20 factors when making independent contractor determinations, but today focuses on three categories of factors: behavioral, financial, and type of relationship.

On January 9, 2024, the U.S. Department of Labor (“DOL”) adopted a regulation changing the criteria it would use in classification cases. Instead of focusing on control like the IRS, the DOL would focus on the economic reality and how dependent the worker is on a purported employer. The DOL and IRS share information on their enforcement of employee classification.

Worker classification affects taxation of both the business and worker, as well as whether the worker should be entitled to the rights and benefits available to employees. States and the federal government have considered legislation to change the classification of certain workers to employees instead of independent contractors. Another approach has been to give certain rights and benefits to independent contractors that would be analogous to what is available to employees. One of those analogous benefits is a portable benefit account. Although the details vary, the goal is to give independent contractors access to tax-favored benefits equivalent to those available to employees.

Proposed Legislation

General

This bill would permit an individual to open and contribute to a portable benefit account if the individual has worked, been hired, or contracted as an independent contractor during the taxable year. Distributions from a portable benefit account would be permitted to be used for the benefit of the individual, the individual’s spouse, and the individual’s dependents, but would be limited to the payment of:

- Health insurance premiums, copays, deductibles, coinsurance, or other costs related to maintaining health insurance coverage;
- Coverage for or the direct purchase of prescription drugs;
- Fees or costs related to a health care sharing ministry arrangement;
- Fees or costs related to a direct primary care agreement; or
- Other health care costs related to insurance coverage, alternative care, or direct-pay or cash-pay services.

Once opened, the individual may contribute to, and take distributions from, the portable benefit account regardless of whether the individual continues to be classified as an independent contractor. There is no penalty or other mechanism to enforce the limitation

on distributions from the account. In order to open a portable benefit account under this bill, the individual would be required to be classified as an independent contractor pursuant to the guidelines published by the IRS.

Taxation

A nonrefundable credit would be allowed for 100% of the amount contributed to a portable benefit account if the individual has worked, been hired, or contracted as an independent contractor during the taxable year. If the credit exceeds the tax liability, the excess would be permitted to be carried over to the next two taxable years. Because the credit would be nonrefundable, it would be limited to the taxpayer's liability. As a result, the calculation of such a credit would not be permitted to include the income and/or tax liability of other household members. Technical amendments are suggested to limit the credit calculation to the individual who owns the portable benefit account, and spouse if a joint return is filed and to limit the credit amount to earnings as an independent contractor.

As the portable benefit account would not qualify for special treatment under the Internal Revenue Code, there would be no federal or Virginia deduction for contributions to the account. Any interest, dividends, or other income earned by funds in the account would be taxable income to the account owner for federal and Virginia purposes. There would be no tax liability for funds distributed from the account; however, some of the expenses paid with distributions could qualify for an itemized or other deduction on the federal or Virginia returns, or both.

Similar Legislation

House Bill 734 would allow a portable benefit account to be created for app-based delivery drivers. The delivery network company would be required to pay 4% of the eligible driver's earnings into the account, which may be used to: (i) compensate for lost income; (ii) transfer funds to an individual retirement account; or (iii) cover expenses incurred for premiums for health insurance coverage in the individual market.

cc : Secretary of Finance

Date: 1/28/2024 JPJ
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