

October 13, 2005

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative constitutional amendment entitled “Hippocratic Oath—Taxation Elimination Medical Compensation, Uninsured Healthcare Coverage, Healthcare Cost Reduction” (File No. SA2005RF0095, Amendment #1-S).

BACKGROUND

Health Coverage and the Uninsured. Most Californians receive health coverage through their employer or the employer of a family member, through the purchase of individual health insurance policies, or through governmental programs such as Medi-Cal or Medicare. However, based upon a 2003 survey, approximately 4 million Californian residents who are United States citizens lacked health insurance coverage at least some point during that year.

Some persons who lack health coverage are eligible to enroll in health coverage provided by government programs such as Medi-Cal, but have chosen not to participate in them. Other uninsured persons are not eligible to enroll for such coverage. Persons who are uninsured for either reason may qualify to receive free or low-cost medical assistance from counties, which are generally responsible under state law for providing health care for indigents. Other uninsured persons rely on free or low-cost health care from medical providers, including private clinics, hospitals, or physicians, often referred to as charity care. In general—depending upon the mechanisms through which such care is provided—the costs of this care may be deductible from gross income as a business expense.

Federal Law. A federal law, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, defines “qualified aliens” as immigrants who are permanent

residents, refugees, and certain other groups who have been granted the legal right to remain in the United States. All other immigrants are considered "nonqualified aliens." Federal law requires that a state that seeks to obtain federal matching funds under the Medicaid program (known as Medi-Cal in California) must provide certain medical services to qualified aliens and emergency services only to nonqualified aliens.

PROPOSAL

State Tax Provisions

This measure provides various state tax advantages to doctors, nurses, and other health professionals who provide health care to uninsured patients. The measure provides that, under specific conditions, certain doctors, other health professionals, and medical centers could avoid paying state income taxes on all, or a portion, of their income. For instance:

- Doctors who register 100 or more uninsured California residents, and the staff of such doctors' offices, would be able to write off on their income taxes the average cost of care for such individuals.
- Doctors who personally register at least 100 patients and provide free quality health care to those registered would be exempt from state income taxes. (We discuss this registration system below.)
- Medical centers, doctors, nurses, and medical professionals working in health care facilities in which all the doctors individually register at least 100 patients and provide free quality health care to those registered would be exempt from the state corporation tax.

This measure requires the state to verify that services claimed as qualifying tax benefits are "quality," free and provided to all registered uninsured patients. In addition, doctors, nurses, and certain other health professionals who work at "capitated" health care facilities would be exempt from all state income taxes, regardless of whether they provided care to the uninsured. Capitated health care facilities are defined by the measure as being those that paid a fixed amount to care for a patient over a given period of time and that employ doctors and other medical professionals on a salaried basis.

Registration for Free Health Care Services

This measure establishes a system by which uninsured U.S. citizens who are California residents could register with physicians to receive free health care services from them. Persons who are enrolled in Medi-Cal could also register with physicians and receive free health care services.

Physicians in turn would have to provide proof to the state that the patients to whom they provided free health care services were California residents and U.S. citizens. This measure requires the state to verify that the patients receiving health care were California residents who were U.S. citizens. Also, the state could assign up to ten additional uninsured patients who have high-risk medical conditions to a medical provider as a condition of their receiving tax-exempt status.

The state would be required to publish and maintain a list of eligible uninsured California residents who were U.S. citizens. The state would also be directed to maintain a single database of all insured and uninsured California residents who were U.S. citizens. Businesses, labor unions, insurers, and other organizations and associations would be required to provide reports to the state on the status of health coverage for all new employees, current employees, and retirees. State and local government departments would be required to report on the status of health coverage of their employees.

Prohibition on Use of State Funds

This measure contains a provision which prohibits the use of state funds for health care costs associated with medical services provided to patients who are not California residents and U.S. citizens.

FISCAL EFFECT

The measure would have a number of major fiscal effects on state tax revenues, state administrative costs, and state and local expenditures for health programs.

Decrease in State Tax Revenues

The number of doctors, nurses, other health professionals, and medical facilities that would be affected by the provisions in this measure regarding state income tax exemptions and deductions is unknown, as is the exact effect on the tax liabilities of these affected parties. Depending upon the response of health care providers to these tax provisions, as well as the interpretation of the measure's tax provisions, state personal income tax and corporation tax revenues would decrease significantly. The annual magnitude of the revenue decrease would be in the hundreds of millions of dollars—potentially exceeding \$1 billion.

State and Local Administrative Costs

The state would incur both one-time costs and ongoing administrative costs to comply with this measure. These would include:

- One-time costs to create a database of insured and uninsured California residents who are U.S. citizens.

- One-time costs for the development of a system to verify tax deductions or tax exempt income for eligible health care providers.
- Ongoing annual expenditures to maintain and update lists of eligible uninsured registrants.

Depending upon how this measure were interpreted, these administrative costs could amount to at least tens of millions of dollars annually. Some of these costs would be onetime and some would be ongoing. Also, state and local government agencies would incur unknown costs for reporting the health coverage status of their employees.

Fiscal Impact on State and County Health Costs

Depending on how this measure were implemented, it could result in either significant savings or costs to the state and to counties for their health care costs. The net effect of the measure on state and county expenditures is unknown.

Specifically, this measure would reduce state and county costs for health care services to the extent that additional patients who would otherwise receive state or local health assistance instead received their medical services from health care providers eligible for the tax deductions and exemptions proposed by this measure. For example, some patients might register with doctors providing free medical services rather than enroll in Medi-Cal, thus resulting in state savings in the Medi-Cal Program. Counties could similarly save on health care costs in cases in which an indigent person received medical services from participating medical providers instead of a county-supported health care clinic.

The exact amount of savings to the state and counties is unknown but would probably be significant. Depending on the level of participation by health care providers and the number of qualified persons who registered to receive free health care services, savings could be as much as hundreds of millions of dollars annually.

The provision of this measure prohibiting any use of state funds for health care for persons who are not California residents and U.S. citizens also would have significant fiscal effects for the state. If this provision were applied to all state health care programs, it might be in conflict with federal legal requirements for state Medicaid programs that emergency services and other medical services be provided to certain qualified and nonqualified aliens who are not U.S. citizens. Thus, it is possible that the state could lose federal matching funds it now receives for support of the Medi-Cal Program. In this event, the state would have increased state costs of as much as \$20 billion annually to offset the loss of these federal funds to continue support for Medi-Cal at present levels.

It is also possible that this initiative would be implemented, in light of these federal requirements, to prohibit the use of state funds for this population only for those health care programs that were not subject to these federal legal requirements. In that event, the state would save on the cost of Medi-Cal services for certain beneficiaries that are not required by federal law as well as for other state health care programs that are not a part of the Medi-Cal Program. These state savings could amount to the low hundreds of millions of dollars annually.

The elimination of state support for these programs could result in an increase in county health care costs for persons who qualified for indigent health care. The cost to counties resulting from this shift in health care services is unknown.

Summary of Fiscal Effects

The measure could have the following major fiscal effects:

- A decrease in state income tax revenues, in the hundreds of millions of dollars—potentially exceeding \$1 billion annually.
- Increased state and county administrative costs, potentially in the tens of millions of dollars annually.
- Significant, but unknown, net savings or costs to the state and county governments for their health care costs for Medi-Cal patients and the uninsured, depending upon how this measure would be implemented in light of federal legal requirements.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael Genest
Acting Director of Finance