

File No. 121124

Committee Item No. 3

Board Item No. \_\_\_\_\_

## COMMITTEE/BOARD OF SUPERVISORS

### AGENDA PACKET CONTENTS LIST

Committee: Budget and Finance Committee

Date 02/06/2013

Board of Supervisors Meeting

Date \_\_\_\_\_

#### Cmte Board

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<input type="checkbox"/>	<input type="checkbox"/>	Resolution
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<input checked="" type="checkbox"/>	<input type="checkbox"/>	Legislative Digest
<input checked="" type="checkbox"/>	<input type="checkbox"/>	Budget and Legislative Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Legislative Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Youth Commission Report
<input type="checkbox"/>	<input type="checkbox"/>	Introduction Form (for hearings)
<input type="checkbox"/>	<input type="checkbox"/>	Department/Agency Cover Letter and/or Report
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<input type="checkbox"/>	<input type="checkbox"/>	Grant Information Form
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Completed by: Victor Young Date February 1, 2013

Completed by: Victor Young Date \_\_\_\_\_

[Administrative Code - Compensation for City Employees with Same-Sex Spouses or Same-Sex Domestic Partners]

Ordinance amending the San Francisco Administrative Code by adding Sections 16.704 and 16.29-7.6 to mandate payments to City employees to offset federal income taxation on health insurance premiums for their same-sex spouses or same-sex domestic partners and to exclude such payments from the computation of compensation under the San Francisco Employees' Retirement System.

NOTE: Additions are single-underline italics Times New Roman;  
deletions are ~~strike-through italics Times New Roman~~.  
Board amendment additions are double-underlined;  
Board amendment deletions are ~~strikethrough-normal~~.

Be it ordained by the People of the City and County of San Francisco:

Section 1. The San Francisco Administrative Code is hereby amended by adding Section 16.704, as follows:

SEC. 16.704. REMEDYING DISCRIMINATION AGAINST EMPLOYEES IN SAME-SEX MARRIAGES OR IN SAME-SEX DOMESTIC PARTNERSHIPS.

(a) Findings and Purpose. The City and County of San Francisco (City) finds that its own employees with same-sex spouses or same-sex domestic partners suffer both dignitary and economic harm as a result of discriminatory federal laws. In particular, as a result of discriminatory treatment under federal tax laws that impose taxes on health care coverage provided to employees with same-sex, but not those with opposite-sex, spouses, City employees with same-sex spouses or same-sex domestic partners suffer not only the indignities of being treated as second-class citizens by their own government; they also suffer measurable financial harm that is concrete, persistent, and significant, and in some cases immense.

1       The City is committed to the equitable principle that all City employees receive equal pay for  
2 equal work. That principle is unattainable for City employees with same-sex spouses or same-sex  
3 domestic partners so long as: (1) state law prevents same-sex couples from marrying; (2) federal law  
4 treats the value of employer contributions for same-sex spouses' or same-sex domestic partners' health  
5 insurance premiums as taxable income, and does not tax employer subsidies for opposite-sex spouses'  
6 health insurance premiums; and (3) federal law prevents the use of pre-tax dollars by employees to pay  
7 health insurance premiums for their same-sex spouses or same-sex domestic partners, while allowing  
8 the use of pre-tax dollars by employees to pay health insurance premiums for their opposite-sex  
9 spouses.

10       In an effort to offset the discriminatory impact of federal taxation on same-sex spouse and same  
11 sex-domestic partner health insurance premiums, and to come closer to achieving the equitable  
12 principle of equal pay for equal work, this Section 16.704 requires the City to make payments to City  
13 employees who are provided subsidies for, and/or who pay all or part of the premiums for, their same-  
14 sex spouses' or same-sex domestic partners' health insurance premiums.

15       (b) For each City employee Health Service System member who is subject to federal  
16 taxation on health insurance premiums paid by the City for a same-sex spouse, or same-sex domestic  
17 partner, the City shall pay an amount equal to twenty (20%) percent of the portion of the employee's  
18 health insurance premiums attributable to the same-sex spouse, or same-sex partner, as determined by  
19 the San Francisco Health Service System. These payments shall not be part of the employee's base pay,  
20 and shall not be included in any overtime or premium pay calculations.

21       (c) Operative Date. This Section 16.704 shall become operative on July 1, 2013.

22       (d) Expiration. This Section 16.704 shall expire in its entirety, or as applied specifically to  
23 one or more of the following three groups of City employees -- employees with same-sex spouses who  
24 married in California; employees with same-sex spouses who married outside of California; and  
25 employees with same-sex domestic partners -- if, and when, the City Attorney's Office certifies to the

1 Mayor and the Board of Supervisors that one or more of those groups of City employees are no longer  
2 subject to discriminatory federal income taxation of health insurance premiums attributable to their  
3 same-sex spouses or same-sex domestic partners. This Ordinance shall continue to apply to those  
4 groups of City employees listed above who continue to be subject to discriminatory federal income tax  
5 on health insurance premiums attributable to their same-sex spouses or same-sex domestic partners.

6 Section 2. The San Francisco Administrative Code is hereby amended by adding  
7 Section 16.29-7.6, as follows:

8 SEC. 16.29-7.6. DEFINITIONS – COMPENSATION PAID TO OFFSET FEDERAL  
9 TAXATION OF HEALTH INSURANCE PREMIUMS FOR CITY EMPLOYEES WITH SAME-SEX  
10 SPOUSES OR SAME-SEX DOMESTIC PARTNERS EXCLUDED.

11 When the compensation of a member is a factor in any computation to be made under the  
12 Retirement System, there shall be excluded from such computation any compensation paid to offset  
13 federal taxation of health insurance premiums for same-sex spouses or same-sex domestic partners.

14 Section 3. In accordance with Section A8.500 of the City Charter, Section 16.29-7.6 of  
15 the Administrative Code requires passage by a three-fourths' vote of the Board of  
16 Supervisors. By certifying that this Ordinance passed the Board on second reading, the Clerk  
17 of the Board is certifying that Section 16.29-7.6 received an affirmative vote of at least three-  
18 fourths of the Board.

19 Section 4. The Board of Supervisors finds that all the sections of this ordinance are  
20 intended and necessary to achieve a single legislative objective. To that end, the provisions  
21 of this ordinance are not severable, and Section 1 of this ordinance and proposed  
22 Administrative Code Section 16.704 shall only be adopted if Section 2 and proposed  
23  
24  
25

Administrative Code Section 16.29-7.6 are adopted by the three-fourths' vote of the Board of Supervisors required by Charter Section A8.500, as provided in Section 3 above.

Section 5. Effective Date. This Ordinance shall become effective 30 days from the date of passage.

Section 6. Expiration of Ordinance Provisions; Removal From Code. Upon expiration of Section 16.704 of the Administrative Code, the City Attorney's Office shall be authorized to remove that provision from the Administrative Code. Administrative Code Section 16.29-7.6 shall not expire.

APPROVED AS TO FORM:  
DENNIS J. HERRERA, City Attorney

By:

Erik A. Rapoport  
ERIK A. RAPOPORT  
Deputy City Attorney

Supervisor Farrell  
**BOARD OF SUPERVISORS**

## **LEGISLATIVE DIGEST**

[Administrative Code - Compensation For City Employees With Same-Sex Spouses Or Same-Sex Domestic Partners To Offset Federal Income Tax On Health Insurance Premiums]

**Ordinance amending the San Francisco Administrative Code, by adding sections 16.704 and 16.29-7.6, to mandate payments to City employees to offset federal income taxation on health insurance premiums for their same-sex spouses or same-sex domestic partners, and to exclude such payments from the computation of compensation under the San Francisco Employees' Retirement System.**

### **Existing Law**

Under federal law, health insurance premiums paid by employees with opposite-sex spouses are not taxed. In contrast, health insurance premiums paid by employees with same-sex spouses, or same-sex domestic partners, must be paid with after-tax dollars. Moreover, the City is required to report, as imputed income on the employee's annual W-2 (Wage and Tax Statement) form, the amount of money the City, as an employer, spends on health insurance premiums attributable to an employee's same-sex spouse or same-sex domestic partner.

### **Amendments to Current Law**

This Ordinance amends the San Francisco Administrative Code to require the City to pay its employees with same-sex spouses, or same-sex domestic partners, twenty percent (20%) of their health insurance premiums attributable to their same-sex spouses or same-sex domestic partners. This Ordinance also amends the Administrative Code to ensure that these payments are excluded from the computation of compensation under the San Francisco Employees' Retirement System.

### **Background Information**

This Ordinance is intended to reduce the discriminatory impact federal tax law imposes on the health insurance premiums of City employees with same-sex spouses, or same-sex domestic partners, by requiring payments to City employees with same-sex spouses, or same-sex domestic partners, to make up for this discriminatory tax burden. This Ordinance also ensures that these payments will not be considered compensation under the San Francisco Employee's Retirement System.

**Item 3**  
**File 12-1124**

**Department:** Health Service System (HSS)

## **EXECUTIVE SUMMARY**

### **Legislative Objective**

The proposed ordinance would amend the San Francisco Administrative Code by adding Sections 16.704 and 16.29-7.6 to mandate payments to City employees to offset Federal income taxes on health insurance premiums paid by the City for their same-sex spouses or same-sex domestic partners, and to exclude such City payments from the computation of compensation under the San Francisco Employees' Retirement System.

### **Key Points**

- City employees who receive health insurance benefits (medical and dental insurance) for their same-sex married spouses or domestic partners are required to pay Federal income taxes on the fair market value of the spouse's or domestic partner's health insurance premiums paid by the City. This requirement can result in some City employees paying annual Federal income taxes of more than \$1,750 on their City-provided insurance benefits.
- Nationwide, more than 30 private employers and at least 2 cities, Cambridge, Massachusetts and Hallandale Beach, Florida, have adopted policies of making additional payments to employees who are married or in a registered domestic partnership with a same-sex spouse or domestic partner, in order to offset the Federal income taxes levied against the fair market value of health insurance benefits.
- The proposed ordinance would authorize the City to make annual payments, in an amount of 20% of the fair market value of health insurance premiums, to City employees affected by the aforementioned Federal income tax. The gross annual payment to most employees would be approximately \$1,400 to \$1,500, depending on the employee's medical and dental insurance providers. This annual payment would partially, but not completely, offset the Federal income tax paid by City employees on the fair market value of health insurance premiums.
- The proposed ordinance would become effective on July 1, 2013. The ordinance would expire if and when the City Attorney certifies to the Board of Supervisors that "City employees are no longer subject to discriminatory Federal income taxation of health insurance premiums attributable to their same-sex spouses or same-sex domestic partners."

### **Fiscal Impact**

- The proposed ordinance would result in a total cost to the City of an estimated \$616,492 per year including (a) total payments to employees of \$572,682, and (b) mandatory employer FICA and Medicare contributions totaling \$43,810. The funding source for this \$616,492 would be General Fund and non-General Fund revenues, depending on the employee's applicable City Department.
- The U.S. Supreme Court will be hearing arguments related to California's 2008 Proposition 8 and the Federal Defense of Marriage Act. The Supreme Court's decisions, expected prior to July 1, 2013, could potentially reduce or eliminate the fiscal impact of the proposed ordinance.

### **Recommendation**

Because the proposed ordinance might result in a new ongoing cost to the City of an estimated \$616,492 per year, approval of the proposed ordinance is a policy matter for the Board of Supervisors.

**MANDATE STATEMENT & BACKGROUND****Mandate Statement**

In accordance with Section 2.105 of the City's Charter, any amendments to the Administrative Code must be approved by ordinance of the Board of Supervisors.

**Background**

The State of California recognizes the marriages of same-sex couples who entered into civil marriage in California between June 17, 2008 and November 4, 2008, as well as same-sex couples who entered into civil marriage in other states and countries, where it was legal, during that time period.<sup>1</sup> Non-married same-sex couples can currently register as domestic partners with the State of California under California Family Code Section 297, by filing either a Declaration of Domestic Partnership or a Confidential Declaration of Domestic Partnership with the California Secretary of State.

When a City employee receives health (medical or dental) insurance for their opposite-sex spouse, the value of the spouse's health insurance is not considered income by the Internal Revenue Service (IRS). However, because the Federal government does not recognize the legal marriages or domestic partnerships of same-sex couples, City employees who receive health insurance for their same-sex married spouses are required, under the Federal Defense of Marriage Act of 1996 (DOMA), to pay income taxes on the fair market value of the portion of the their health insurance attributable to their same-sex spouse or domestic partner.<sup>2</sup>

The fair market value of the health insurance premiums paid by the City, extended to same-sex spouses and domestic partners, is listed on City employees' Tax Form W-2 as "imputed income" which, for tax purposes, is treated the same as wages. The San Francisco Health Service System (HSS) has estimated that 386 City employees pay Federal income tax on the fair market value of the health insurance premium paid by the City. This fair market value ranges from \$7,000 to \$7,500 for most City employees annually, depending on the employee's medical and dental insurance providers. The additional Federal income tax owed by City employees can amount to more than \$1,750 per year. Therefore, while two City employees may otherwise receive identical health insurance benefits, the financial outcomes of those two employees are different if one employee is taxed on that benefit and the other is not.

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<sup>1</sup> Per the California Supreme Court ruling, *Strauss v. Horton*, May 26, 2009. June 17, 2008 was the first date civil marriages were legally performed in California, following the May 2008 California Supreme Court decision *In re Marriage Cases*. California Proposition 8, which defines marriage as between a man and a woman, was passed on November 4, 2008.

<sup>2</sup> The Federal government makes an exception to the taxation of health benefits, as described above, for employees who declare their same-sex spouse or domestic partner as a Medical Dependent. In San Francisco, City employees may file a declaration with the Health Service System (HSS) declaring a Medical Dependent, in which case the City does not have imputed income included as their end-of-year taxable income. To qualify as a Medical Dependent, the City Employee's beneficiary must (1) live in the same principal abode, (2) be a U.S. citizen, U.S. national, or resident of Canada or Mexico, and (3) receive more than half of his or her support from the City employee during the year, as defined by the IRS.



In response to the differential Federal income tax treatment of employees, some employers are adjusting their fringe benefits so that all employees receive similar after-tax employment benefits. Nationwide, more than 30 private employers and at least 2 cities—Cambridge, Massachusetts and Hallandale Beach, Florida—have adopted a policy of making additional payments to employees who are married or in a registered domestic partnership with a same-sex spouse, in order to offset the Federal income taxes levied against the fair market value of health benefits.

## DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend the San Francisco Administrative Code by adding Sections 16.704 and 16.29-7.6 to mandate payments to City employees to offset Federal income taxes on health insurance premiums paid by the City for their same-sex spouses or same-sex domestic partners and to exclude such City payments from the computation of City employees' compensation under the San Francisco Employees' Retirement System.

The purpose of the legislation is to offset the Federal income tax on same-sex spouse and same-sex domestic partner health insurance premiums, as described in the Background section, above. The proposed ordinance would achieve this goal by making payments to City employee Health Service System members who are provided subsidies for, and/or who pay all or part of the premiums for, their same sex spouses' or same-sex domestic partners' health insurance premiums. The proposed ordinance would not apply to City employees who declare their same-sex spouses or domestic partners to be Medical Dependents, as described in Footnote 2 in the Background section above. In addition, the proposed ordinance would not apply to opposite-sex domestic partners.

Under the proposed ordinance, the City would make payments to City employees who are members of the Health Service System, including elected officials and department heads, in an amount equal to 20% of the portion of the employee's medical insurance premiums paid by the City attributable to the same-sex spouse, or same-sex partner. These payments would not be counted toward the employee's base pay, nor would the payments be included in overtime, premium pay, or retirement calculations. The Controller has proposed that the City would make these payments to City employees annually at the end of each calendar year. Federal tax law prohibits these payments from being considered pretax income.

The proposed ordinance includes an operative date of July 1, 2013. Under Section 16.704(d) of the proposed ordinance, the ordinance would expire if and when the City Attorney certifies to the Board of Supervisors that "City employees are no longer subject to discriminatory Federal income taxation of health insurance premiums attributable to their same-sex spouses or same-sex domestic partners."

## FISCAL IMPACT

The proposed ordinance would authorize payments by the City to City employees in an amount equal to 20% of the portion of the qualifying employee's health insurance premiums paid by the City attributable to the same-sex spouse, or same-sex domestic partner, as determined by HSS. Under the proposed ordinance, these payments to City employees (a) would not be part of the

employee's base pay, (b) would not include or relate to overtime, and (c) would not apply toward premium pay or retirement calculations. The 20% calculation is an approximation of the marginal Federal income tax that would be paid on the fair market value of the spousal health insurance premiums.

As is noted above, HSS estimates that 386 City employees would be affected by this ordinance. Under the proposed ordinance, most employees would receive a payment of between \$1,400 and \$1,500, depending on their medical and dental insurance providers. The total cost to the City is estimated to be \$616,492 per year including (a) total payments to employees of \$572,682, and (b) mandatory employer FICA and Medicare contributions totaling \$43,810.

**Table 1. Estimated Costs of Proposed Ordinance**

<b>Medical Insurance Plans</b>	<b>Total Employee Count</b>	<b>Total Fair Market Value (A)</b>	<b>Total Payment to Employees (A * 20% = B)</b>	<b>Employer FICA &amp; Medicare (A * 7.65% = C)</b>	<b>Total Cost to City (B+C)</b>
Kaiser	128	\$866,944	\$173,389	\$13,264	\$186,653
Blue Shield	214	1,593,658	318,732	24,383	343,115
City Plan	11	89,661	17,932	1,372	19,304
<i>Medical Insurance Subtotal</i>	353		\$510,053	\$39,019	\$549,072
<b>Dental Insurance Plans</b>	<b>Total Employee Count</b>	<b>Total Fair Market Value (A)</b>	<b>Total Payment to Employees (A * 20% = B)</b>	<b>Employer FICA &amp; Medicare (A * 7.65% = C)</b>	<b>Total Cost to City (B+C)</b>
DeltaCare	6	\$1,463	\$293	\$22	\$315
Delta Dental	374	310,375	62,075	4,749	66,824
Pacific Union Dental	6	1,303	261	20	281
<i>Dental Subtotal</i>	386		\$62,629	\$4,791	\$67,420
<b>Total</b>			<b>\$572,682</b>	<b>\$43,810</b>	<b>\$616,492</b>

Sources: Medical Insurance subscription information provided by Department of Human Resources (DHR). Dental Insurance information provided by HSS. Cost estimates by Budget and Legislative Analyst.

The source of funds for the \$616,492 would be from General Fund and non-General Fund revenues, depending on the employee's applicable City department. Appropriation authority would be included in the FY 2013-14 and FY 2014-15 Annual Appropriation Ordinance, which will be subject to Board of Supervisors approval in June 2013. The exact breakdown of the General Fund and non-General Fund sources for the \$616,492 was not available at the time of this report.

According to Mr. Steven Ponder, Classification and Compensation Manager for DHR, the added administrative requirements for administering the proposed ordinance would be absorbed by existing City staff.

### **Two 2013 U.S. Supreme Court Cases Could Reduce or Eliminate the Fiscal Impact of the Proposed Ordinance**

On December 7, 2012, the U.S. Supreme Court announced that it will hear arguments in two cases before the Court: (1) *United States v. Windsor*, which is likely to decide the constitutionality of the Federal Defense of Marriage Act (DOMA), which defined marriage as between a man and a woman in Federal considerations, including Federal income tax law; and (2) *Perry v. Brown*, which is likely to decide the constitutionality of California's 2008 Proposition 8, which defined marriage as between a man and a woman in California. The arguments for both cases will be heard in late March 2013, with Supreme Court decisions to be made by late June 2013.

The outcome of these cases could reduce or eliminate the fiscal impact of the proposed ordinance. According to Deputy City Attorney Therese Stewart, the four most likely Supreme Court outcomes and their impacts on the proposed ordinance are described below:

1. A Supreme Court decision results in both DOMA and Proposition 8 being declared unconstitutional: Couples could legally marry in California and same-sex married couples would no longer be responsible for paying Federal income tax on medical benefits, thereby eliminating the need for, and entire fiscal impact of, the proposed ordinance.
2. A Supreme Court decision results in DOMA being declared unconstitutional, but the Court does not overturn Proposition 8: Legally married same-sex spouses would no longer be responsible for paying income taxes on spousal medical benefits. However, couples would not be able to legally marry in California, and same-sex domestic partners would continue to be responsible for the income tax. As a result, the fiscal impact of the proposed ordinance would be somewhat reduced, to account for same-sex couples legally married in 2008. HSS is not able to determine the reduced fiscal impact at this time.
3. A Supreme Court decision results in Proposition 8 being declared unconstitutional, but the Court does not overturn DOMA: Legally married same-sex spouses and same-sex domestic partners would continue to be responsible for paying Federal income taxes on medical benefits for their partners, resulting in no change to the fiscal impact of the proposed ordinance, as described above.
4. A Supreme Court decision upholds both DOMA and Proposition 8: This scenario results in the status quo, and therefore there would be no change to the fiscal impact of the proposed ordinance, as described above.

The Supreme Court's decisions are expected prior to July 1, 2013, the effective date of the proposed ordinance. In the event that the Court's decisions result in Scenario 1 above, the proposed ordinance would expire, per the terms described in the "Details of Proposed Legislation" section above, and there would be no cost to the proposed ordinance.

**POLICY CONSIDERATIONS****The Proposed Changes Would Only Apply to City Employees,  
But Not Others that Qualify for the Health Service System**

Section 16.700 of the Administrative Code lists the various categories of individuals that may participate in the Health Service System. The proposed ordinance applies to City employees, and as revised, to department heads and elected officials as well. However, it would not apply to other individuals that are eligible to participate in the City's Health Service System, including members of select boards and commissions; officers and employees of the Board of Education of the San Francisco Unified School District; officers and employees of the Governing Board of the San Francisco Community College District; and retirees, among others.

**The Proposed Ordinance Would Not Entirely Offset the Federal Income Tax on  
Most City Employees Spouse's or Domestic Partner's Health Insurance**

Under the proposed ordinance, City employees who pay Federal income taxes on the fair market value of their same-sex spouse's or domestic partner's health insurance premiums paid by the City would receive an annual payment from the City in an amount equal to 20% of the fair market value. That 20% fair market value payment, as noted above, would range from \$1,400 to \$1,500 for most City employees, and would still be subject to all regular state and Federal paycheck deductions. Therefore, the City employee would only keep a portion of the 20% fair market value payment.

Furthermore, according to information provided by the Controller's Office, approximately 96% of City employees pay a marginal Federal income tax rate of 25% or above (in 2010, 34% of City employees paid a marginal tax rate of 25%; 57% of City employees paid a marginal tax rate of 28%; and 5% of City employees paid a marginal tax rate of 33%). The Budget and Legislative Analyst estimates most participating City employees who receive the estimated \$1,400 payment under the proposed ordinance would owe the IRS at least \$1,750 in Federal income taxes on the value of the health insurance premium paid by the City – a difference of \$350, before considering the required paycheck deductions. Therefore, the payment of 20% of fair market value of the health insurance premium paid by the City will not completely offset the Federal income tax on fair market value paid by those employees who receive health insurance coverage for same-sex spouses and domestic partners.

**RECOMMENDATION**

Because the proposed ordinance might result in a new ongoing cost to the City of an estimated \$616,492 per year, approval of the proposed ordinance is a policy matter for the Board of Supervisors.