

SUMMARY ANALYSIS OF AMENDED BILL

Author: Dutton Analyst: Raul Guzman Bill Number: SB 553
 Related Bills: See Prior Analysis Telephone: 845-4624 Amended Date: May 31, 2005
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Home Ownership Development Account/Exclusion of Interest Income and a \$10,000 Deduction/Nontaxable Distributions

DEPARTMENT AMENDMENTS ACCEPTED.

AMENDMENTS IMPACT REVENUE. No impact to revenue from the amendment.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced February 18, 2005.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 18, 2005 STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would create an “individual homeownership development account” (IHDA) that would include certain income tax benefits similar to an individual retirement account (IRA).

SUMMARY OF AMENDMENTS

The May 31, 2005, amendments added language that would allow matching funds to be returned to the contributors of those funds under certain circumstances. The amendments would allow taxpayers to withdraw funds from an IHDA for qualified individual homeownership development expenses without being subject to minimum age or time restrictions.

The May 16, 2005, amendments added language that would allow a deduction to employers for matching contributions. These changes were removed by the May 31, 2005, amendments above. The amendments also made several clarifying changes.

As a result of the May 31, 2005, amendments, the “This Bill” discussion contained in the analysis of the bill as introduced February 18, 2005, has been revised. In addition, some of the department’s concerns addressed in the prior analysis have been resolved. A new implementation concern has been identified and is included below with the remaining implementation and policy concerns. The remainder of the department’s analysis of the bill as introduced February 18, 2005, still applies.

Board Position:	Legislative Director	Date
_____ S		
_____ SA	Jana Howard for Brian Putler	6/16/05
_____ N		
_____ NA		
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_____ OUA		
_____ NP		
_____ NAR		
<input checked="" type="checkbox"/> PENDING		

POSITION

Pending.

THIS BILL

This bill would create an IHDA. The bill would provide that the interest and other money earned and the requirements and limitations on the IHDA would receive the same treatment as a traditional IRA. The gross interest income and other money earned by the account would not be taxable, and a taxpayer could deduct up to \$10,000 in annual contributions made to the IHDA. This bill would also allow other persons to make contributions of matching funds to the IHDA.

The bill specifies that only one IHDA account could be established per individual taxpayer, hereafter beneficiary.

The bill would define an IHDA as a trustee account that:

- Is designated as an individual homeownership development account.
- Has a written governing instrument creating the account and provides that all contributions are required to be in cash, the account exclusively benefits the individual beneficiary establishing the account, and the distributions from the account will be used to pay for "qualified individual homeownership development expenses."
- Is subject to the same requirements and limitations as a traditional IRA.
- Is not subject to age or time limitations on distributions.

This bill defines "qualified individual homeownership development expenses" as expenses incurred, including the down payment, by the beneficiary in connection with the purchase of the beneficiary's first principal residence. "Trustee" would have the same meaning as under the traditional IRA.

This bill specifies that contributions of matching funds to an IHDA would be disallowed if the person contributing those funds receives any earnings or other investment returns on the contribution. The bill would require that if it becomes unlikely that the matching funds made by a contributor would be used to purchase a qualified IHDA, the matching funds would be returned to the contributor.

This bill would provide that any amount withdrawn from the IHDA is included in income unless the distribution is made to pay for qualified individual homeownership development expenses of an individual that established the IHDA. However, contributions to the IHDA made by persons other than the beneficiary would be included in the income of the beneficiary if the distributions were not used to pay for qualified individual homeownership development expenses.

This bill states that the residence shall not be considered an individual's first-time residence if the beneficiary or the beneficiary's spouse held ownership interest in a residence that was the principal residence in this state during the two-year period preceding any purchase with the IHDA funds. The residence would also not qualify as a first-time residence if the purchase price is greater than 120 percent of the median home sales price in the county in which the residence is located.

The deduction for contributions to the IHDA created by this bill would be a miscellaneous itemized deduction subject to the 2% of AGI floor limitation.

IMPLEMENTATION CONSIDERATIONS

The first two concerns below were identified after the bill was amended; the remaining three concerns were identified on the original analysis and repeated here for convenience.

The bill states that if it becomes unlikely that the matching funds will be used to purchase a qualified IHDA, the matching funds will be returned to the contributor. The bill lacks direction for what should happen with any income generated by the contribution. The author may wish to amend the bill to indicate what would happen to the income generated by those funds.

The bill describes a qualified first-time residence. In addition the bill indicates that the residence will not qualify as a first-time residence if the purchase price is greater than 120 percent of the median home sales price in the county where the residence is located. The department's expertise is in the administration of taxes. Thus, the author may wish to add a provision that would specify a state agency, local agency, or the bank managing the IHDA to be responsible for determining median home sales prices.

Traditional IRA's defer or exclude from income all earnings generated within those accounts. The bill as amended would exclude interest and other moneys. "Interest and other moneys" is vague and would lead to disputes between taxpayers and the department regarding its scope. The author may want to revise the income exclusion wording from "interest, and any other moneys" to "earnings from this type of account."

The bill does not limit the amount that may be matched and contributed to the IHDA. As a result, the person matching the contribution would not be limited on the amount that he or she may contribute to the IHDA. If the author does not intend to place a limit on the matching contribution amount, then no change would be necessary. In addition, it is unclear whether taxpayers making matching contributions would be allowed a deduction for their contributions up to the \$10,000 maximum deduction.

The language in this bill looks to the purpose for which the distribution was made and not how the funds were used. Current law for IRA's places the emphasis on how the funds were used. This bill states that unless a payment or distribution is made to pay for IHDA expenses, that payment or distribution is not taxable. The author may wish to amend the bill to refer to how the funds are used rather than how the distribution is made.

POLICY CONCERNS

The deduction and exclusion provided by this bill would not be limited to taxpayers purchasing homes in California. Nevertheless, restrictions based on property located within the state have been the subject of constitutional challenges as explained below.

The U.S. Court of Appeals for the 6th Circuit ruled in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738 that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. Ohio is seeking review by the U.S. Supreme Court. Although the outcome of this decision and its affects on the income tax credits of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

Recently introduced federal legislation titled the "Economic Development Act of 2005," S. 1066 and H. R. 2471, would authorize state tax incentives for economic development purposes that may otherwise be subject to constitutional challenge as discriminatory.

This bill would create a state and federal difference, which adds complexity to the tax return as the income excluded or deferred by this bill is still subject to federal income tax. The absence of similar federal treatment may dissuade banks from embarking on the California-only IHDA, since they will need to keep separate accounting of the deposits and withdrawals for state and federal tax purposes.

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