Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Caballero/Solorio, et al.	Analyst:	Angela Raygoza	Bill Number:	AB 765
Related Bills:	See Prior Analysis	Telephone:	845-7814	Amended Date:	June 24, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Principal Residence Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ___________________.

_X_ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 21, 2009, STILL APPLIES.

_X_ OTHER – See comments below.

SUMMARY

For purposes of the Principal Residence Credit, this bill would require the Franchise Tax Board (FTB) to estimate the average credit amount used, and reduce the remaining amount of aggregate credit available by that amount, as specified.

SUMMARY OF AMENDMENTS

The June 24, 2009, amendments would do the following:

- Require an enforceable contract, as specified,
- Require FTB to reduce the total remaining amount of credits allocated by the average tax credit usage,
- Add language that would specify that the bill would be an urgency statute, and
- Add a co-author.

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	07/03/09
____ N	____ OUA	_X_ PENDING		

As a result of the amendments, the “Effective/Operative Date,” “This Bill,” “Implementation Considerations,” “Fiscal Impact,” and “Economic Impact,” as provided in the department’s analysis of the bill as amended May 21, 2009, have been revised. The implementation considerations and policy concern from the department’s analysis of the bill as amended on May 21, 2009, have been repeated below for convenience. The June 24, 2009, amendments raise technical concerns that have been addressed in the discussion below. The “Program Background” discussion has been provided below to reflect the status of the aggregate credit allocation limit. The remainder of the department’s analysis as of May 21, 2009, still applies.

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this bill would be effective immediately upon enactment and specifically operative for purchases that occur on or after March 1, 2009, and before December 1, 2010. The purchase of a qualified principal residence that occurs on or after March 1, 2010, and before December 1, 2010, must be made pursuant to an enforceable contract to purchase the qualified principal residence executed prior to March 1, 2010.

SUMMARY OF SUGGESTED AMENDMENTS

The following suggested amendments are provided to resolve technical and implementation considerations and provide for an appropriation to fund the department’s costs to implement the bill.

Amendment 1 is provided to revise the date to purchase a qualified principal residence from March 1, 2010, to December 1, 2010, to be consistent with home purchase dates that are made with an enforceable contract.

Amendment 2 has been provided for consistency with the revised allocation methodology.

Absent clarity of how to determine the average tax credit, Amendment 3 has been provided as an alternative that would use an average rate of 70 percent, as discussed in “Economic Impact,” for purposes of allocating the credit.

Amendment 4 has been provided to clarify that implementation of the bill’s provisions are contingent upon receipt of funding in the annual budget act.

Amendment 5 provides suggested language to fund the department’s costs to implement the bill’s provisions.

ANALYSIS

PROGRAM BACKGROUND

Newly enacted state law, SBX2 15 (Ashburn, Stats. 2009 Third Extraordinary Session, Ch. 11), provides a tax credit in the amount of 5 percent of the purchase price of a qualified principal residence or $10,000, whichever is less. The credit is allowed for one purchase of a qualified principal residence by an individual, for purchases made on or after March 1, 2009, and before March 1, 2010. Within one week of the sale of the qualified principal residence, the seller is required to provide to the purchaser and to the FTB certification that the residence has never been previously occupied. Total credit is limited to $100 million, which is allocated on a first-come, first served basis, based on receipt of certification from the seller.

As of July 1, 2009, FTB had received 11,925 applications representing an excess of $100 million in tax credits for new home purchases. Because some of the applications are duplicates, revised, or invalid, FTB has accepted as of July 2, 2009, approximately 12,000 applications to ensure there are sufficient valid applications to allocate the full $100 million.

THIS BILL

To qualify for the principal residence credit, this bill would require that home purchases made between March 1, 2010, and December 1, 2010, have an enforceable contract executed prior to March 1, 2010.

Under this bill, a taxpayer would be allowed to reserve a credit prior to the close of escrow. To reserve the credit, the taxpayer and seller would be required to jointly sign and submit to FTB certification that the taxpayer and seller have entered into the agreement on or after March 1, 2009, and before March 1, 2010. FTB would be required to conditionally reserve the credit upon receipt of the certification.

This bill would continue to require that the seller provide certification to the taxpayer and FTB within one week of the close of escrow of the qualified principal residence and that allocation would be based on the receipt of certification from the seller regarding the eligibility of the property qualifying as a “new home” as defined.

Under this bill, FTB would be required to reduce the total remaining amount of aggregate credits available for allocation by the average tax credit that FTB estimates would be used by the average taxpayer. For example, if the average credit usage estimated by FTB is $7,000, a taxpayer would be allocated the full $10,000 credit, but the total amount of credits available for allocation would be reduced by $7,000. As a result, additional taxpayers could be allocated the credit.

IMPLEMENTATION CONSIDERATIONS

The implementation concerns from the May 21, 2009, analysis are listed below. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses a term that is undefined, "conditionally reserve." It is unclear what the conditions would be to reserve the credit under which the credit would be reserved but not allocated. The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill would allow a taxpayer to reserve a credit prior to the close of escrow. It is unclear whether the reservation of a credit would reduce the credit available for allocation. It is also unclear how or when the department would be notified if the taxpayer cancels escrow. In addition, the bill fails to specify how the department would handle such a cancellation. For example, a taxpayer reserves a credit prior to the close of escrow. The taxpayer cancels escrow and fails to notify FTB. If the reservation of credit reduces the amount available for allocation, a portion of the total remaining credits available would have been allocated and would not be available for taxpayers that close escrow and submit the necessary certification later. To ease administration of this bill, it is recommended that the bill be amended to clarify the intent to avoid confusion by taxpayers.

The June 24, 2009, amendments raise additional implementation concerns, as follows:

Because this bill requires a seller to provide the certification to the taxpayer and to the FTB within one week of the close of escrow, it would create a challenge for FTB if this bill is enacted into law for those taxpayers that closed escrow after the aggregate allocation cap has been reached. Because this bill has not been enacted before FTB stopped accepting applications, the language of the law creates a legal obstacle for equitable treatment. To ease administration of this bill, it is recommended that the bill be amended to clarify the treatment of taxpayers that close escrow after the allocation cap has been reached.

FISCAL IMPACT

Staff estimates a combined one-time cost of approximately $147,000 (2.0 PYs) to develop, program, and test revisions to existing systems, the reservation process and the application of an average credit amount to the current allocation limit and new application received for the principal residence credit. Implementation of this bill is contingent on funding. Suggested language is provided in Amendment 5 to fund the department's costs to implement the bill. If appropriation language is not included in the bill's provisions, the department would be required to pursue budget augmentation through the normal budgetary processes, which would delay implementation of the bill's provisions.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 765 As Amended June 24, 2009 Effective For Purchases Made On or After March 1, 2009, and Before March 1, 2010 Assumed Immediate Enactment ($ in Millions)		
2009-10	2010-11	2011-12
-$14	-$11	-$6

Revenue Discussion

The revenue impact of this bill would depend on the number of taxpayers that purchase a new or previously unoccupied single-family home and are currently unable to apply for the Qualified Principal Residence Purchase Credit due to the credit's $100 million allocation limitation. As of June 24, 2009, 10,633 applications totaling $102 million in credits were submitted to the department.

Based on data from the California Builder Association for 2008 and using the Department of Finance's growth projections for new home starts as a proxy for growth in new home sales, it is estimated that approximately 33,500 new homes will be sold during 2009 in California. To exclude investment purchases, because qualified purchases must serve as a taxpayer's primary residence, projected new home sales for 2009 are reduced by 5 percent to 31,800 [33,500 x (1- 5%)]. Next, because qualified purchases are limited to those made on or after March 1, total sales for 2009 are reduced by 17 percent (2 months ÷ 12 months) to approximately 26,400 [31,700 x (1-17%)].

Current law provides a 5 percent or $10,000 credit for qualified purchases up to $100 million in total credits. This equates to 10,000 purchases ($100 million ÷ $10,000 creditable amount).

This bill would require the FTB to track credits allocated based on an estimated usage. Thus, the credit allocation limit of $100 million (representing 10,000 taxpayers at $10,000) would be reduced by the average estimated usage amount. Based on a sample of the taxpayers approved for the home credit, their 2007 income tax liabilities, and incorporating 2009 tax law changes, it is estimated that on average, of the $3,333 individual annual limit ($10,000 ÷ 3), that 70 percent or $2,333 ($3,333 X.70) would be used to reduce income tax liabilities. Applying this percentage to the $10,000 credit available,(30% x $10,000), $7,000 is estimated to be the average credit used over a three-year income tax period. [1] Of the $100 million currently approved to be used by

[1] Recently enacted law ABX3 3 (Evans, Stats. 2009, Ch. 18) temporarily adds .25% to each personal income tax rate for taxable years 2009 and 2010, .25% to the alternative minimum tax rate, and reduces the dependent exemption credit from $309 to $99.

10,000 taxpayers, $70 million (10,000 taxpayers x $7,000) is estimated to be used to reduce taxes for tax year 2009, 2010, and 2011. Therefore, under this bill, $30 million would remain for credit usage. New credits generated under this bill would allow approximately 4,285 additional purchases to qualify ($30 million ÷ $7,000 credit amount). The department would accept an additional 4,285 applicants, allocate $10,000 (or $42.85 million) but would only account for $7,000 per taxpayer, thus resulting in an increase in credit usage of approximately $30 million (4,285 additional purchases x $7,000 estimated used to reduce taxes) over three years.

New home projections for 2009 are estimated to exceed 25,000; after subtracting the 10,000 purchases that are allowed under current law, the remaining 15,000 sales are anticipated to exceed the additional 4,285 purchases that would become eligible for the credit under this bill.

Beginning with the tax year of the purchase, current law requires that no more than one-third of credits generated be used in each of the three taxable years. For 2009, this reduces credits used to $10 million ($30 million ÷ 3 years). The figures in the chart have been adjusted to reflect the cash flow impact on a fiscal-year basis. The revenue loss for fiscal year 2009-10 includes additional credits allocated and used for tax year 2009 and altered estimate payments for credits available for the 2010 tax year.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 765
As Amended June 24, 2009

AMENDMENT 1

On page 2, line 5, strikeout "March" and insert:

December

AMENDMENT 2

On page 3, line 23, strikeout "allowed" and insert:

allocated

AMENDMENT 3

On page 3, strikeout lines 30-33 and insert:

received from a seller, the total remaining amount of credits available for allocation shall be reduced by an amount equal to seventy percent of the credit allowable to the taxpayer.

AMENDMENT 4

On page 4, after line 20, insert:

(i) Implementation of the amendments added by this section shall be contingent on the appropriation of funds for the purposes of this section in the annual Budget Act.

AMENDMENT 5

On page 4, after line 28, insert:

SEC. 3 The sum of one hundred forty-seven thousand dollars ($147,000) is hereby appropriated to the Franchise Tax Board in augmentation of item 1730-001-0001 of the Governor's Budget, Chapter XX, Statutes of XXXX.