Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Bill Number: SBX3 38
Related Bills: See Legislative History
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Amended Date: May 13, 2009
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Sponsor:

SUBJECT: Qualified Principal Residence Purchase Credit

SUMMARY

This bill would make substantive changes to the Qualified Principal Residence Credit.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to stimulate the economy and restore the housing market.

EFFECTIVE/OPERATIVE DATE

As a tax levy, 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.

POSITION

Pending.

ANALYSIS

FEDERAL LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:			Department Director	Date
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First-Time Homebuyer's Credit

Housing and Economic Recovery Act of 2008 (Public Law 110-289)

A "first-time homebuyers" credit was enacted by the Housing and Economic Recovery Act of 2008. The Act added a new refundable tax credit for "first-time homebuyers." The amount of the credit is the lesser of $7,500 or 10 percent of the home's purchase price. The credit is phased out for taxpayers with adjusted gross income[1] (AGI) between $75,000 and $95,000 ($150,000 and $170,000 for joint filers). The credit applies to principal residences purchased after April 8, 2008, and before July 1, 2009.

The credit is recaptured under the terms of Internal Revenue Code (IRC) section 36(f) over 15 years with no interest charge, beginning with the second tax year after the tax year in which the home is purchased. If the home is sold before the 15-year period ends, the remaining credit must be recaptured in the year of sale.

American Recovery and Reinvestment Act of 2009 (Public Law 111-5)

The "first-time homebuyers" credit was modified by the American Recovery and Reinvestment Act of 2009. In general, for homes purchased after December 1, 2008, and before December 1, 2009, the maximum credit allowed is increased to $8,000 ($4,000 for married individuals filing separately). The credit is no longer required to be recaptured unless the taxpayer sells the qualified residence within 36 months. The credit applies to homes that are financed by exempt mortgage revenue bonds or located in the District of Columbia.

STATE LAW

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 and 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.

The tax credit is allocated by FTB with a maximum of $100 million. Upon receipt of certification from the seller, the credit is allocated on a first-come, first-serve basis. The credit must be claimed on a timely filed original return. The determination by FTB with respect to the date a certification is received, and whether a return has been timely filed, may not be reviewed in any administrative or judicial proceeding. Any disallowance of a credit claimed on the basis of exceeding the $100 million limitation is treated as a mathematical error and any tax resulting from such disallowance may be assessed in the same manner as applicable to mathematical errors. The newly enacted state law remains in effect until December 1, 2013, and is repealed as of that date.

[1] Adjusted gross income, as defined by IRC section 62, means gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

THIS BILL

This bill would extend the operative period for the Qualified Principal Residence Purchase Credit from purchases made before March 1, 2010, to purchases made before December 1, 2010. This bill would require an enforceable contract for purchases occurring after March 1, 2010, and prior to December 1, 2010, to purchase the qualified principal residence be executed prior to March 1, 2010.

Under this bill, the 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 specify that the seller provide certification to the taxpayer and FTB within one week of the close of escrow of the qualified principal residence.

This bill would also increase the aggregate credit allocation amount from $100 million to $300 million.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. 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 increase the credit allocation amount from $100 million to $300 million. It is unclear how the credit would be allocated if the total allocated credit limit of $100 million is reached prior to enactment of this bill. For example, if the credit allocation amount of $100 million is reached by July 1, 2009, and this bill is enacted on September 30, 2009, there will be three months where the credit will be unavailable for allocation. To ease administration of this bill, it is recommended that the bill be amended to specify how claims for credit should be applied if the aggregate credit allocation provided under existing law is completely allocated.

This bill would allow a taxpayer to reserve a credit prior to the close of escrow. It is unclear if the reservation of a credit would reduce the credit available for allocation. It is 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 $300 million 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.

LEGISLATIVE HISTORY

AB 765 (Calderon and Solorio, 2009/2010) is identical to this bill. AB 765 is currently in the Assembly Appropriations Committee.

AB 902 (Torres, 2009/2010) would allow a maximum credit of $3,000 for the amounts paid or incurred by a taxpayer for a single purchase of foreclosed property that would be the primary residence for the taxpayer. This bill was held in the Assembly Revenue and Taxation Committee.

SB 49 (Dutton, 2009/2010) would make substantive changes to the Qualified Purchase residence credit similar to this bill. SB 49 would eliminate the provision that would allow the taxpayer to reserve the credit and would eliminate the current aggregate allocation cap of $100 million. This bill is currently in the Senate Revenue and Taxation Committee suspense file.

SB 206 (Dutton, 2009/2010) would allow a maximum credit of $8,000 for a taxpayer that purchases a qualified principal residence on or after January 1, 2009, and before December 1, 2009. To qualify for the credit a taxpayer could not own a principal residence during the three-year period prior to the date of purchase. This bill was held in the Senate Revenue and Taxation Committee.

SBX 2 15 (Ashburn, Stats. 2009 Third Extraordinary Session, Ch. 11) allows a $10,000 credit for the purchase of a qualified principal residence for purchase made after March 1, 2009, and before March 1, 2010. The credit is being allocated by FTB with a maximum allocation of $100 million.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of SBX3 38 Introduced May 13, 2009 Assumed Enactment After June 30, 2009 ($ in Millions)		
2009/10	2010/11	2011/12
-$17	-$17	-$14

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

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.

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 approximately 31,800 [33,500 x (1- 5%)]. Next, because qualified purchases are limited to those made on or after March 1, 2009, total sales for 2009 are reduced by 17 percent (2 months ÷12 months) to approximately 26,400 [31,700 x (1-17%)]. For tax year 2010, qualified purchases are estimated to total approximately 9,200. This was derived by using the same methodology outlined above and includes additional sales for taxpayers that are anticipated to enter into a contract before March 1, 2010, and close of escrow later in the year but before December 1, 2010.

For both tax years, qualifying purchases are estimated to total approximately 35,600 (26,400 for 2009 + 9,200 for 2010). 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 credit amount). The remaining qualified purchases, above the current limit of 10,000, would total approximately 25,600 (35,600 – 10,000). Increasing the credit allocation limit would result in the allocation of an additional $200 million in credits or approximately 20,000 purchases ($200 million ÷ $10,000); this would cover the remaining qualified purchases during 2009 estimated at approximately 16,400 with the remaining 3,600 purchases (20,000 -16,400) taking place during 2010.

Credits generated during 2009 are estimated to total approximately $164 million (16,400 purchases x $10,000 credit amount) with remaining $36 million in credits (3,600 purchases x $10,000) allocated during 2010. To determine the value of credits used to reduce taxes, taxpayers without a tax liability were excluded. It is assumed that one-third of the homebuyers who do not have a tax liability will receive certification for the credit, reducing credits available for use to approximately $109 million [$164 million x (1-33%)].

Starting 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 available credits for use to approximately $36 million ($109 million ÷ 3 years). Of this $36 million, it is assumed that taxpayers would have sufficient tax liability to use 38 percent of the available credits in each year. The revenue loss to the state from 2009 purchases is estimated to be approximately $14 million ($36 million x 38%) per year for three years. Using the same methodology for 2010 purchases, estimated losses are approximately $3 million per year for three years. The revenue loss for fiscal year 2009-10 includes approximately $14 million in new credits applied to reduce tax year 2009 liabilities and approximately $3 million in reduced estimated payments for tax year 2010 liabilities. The figures in the chart have been adjusted to reflect the cash flow impact on a fiscal-year basis.

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