ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Calderon	Analyst:	Angela Raygoza	Bill Number:	SBX8 39
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	February 8, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Principal Residence Credit

SUMMARY

This bill would do the following:

- **Provision 1:** Extend the principal residence credit by a specified date and revise the amount of credit that may be allocated to taxpayers, and

- **Provision 2:** Enact a new principal residence credit with an increased allocation limit amount as specified.

PURPOSE OF THE BILL

According to the language of the bill, the purpose is to address the fiscal emergency declared by the Governor by proclamation on January 8, 2010.

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this bill would be effective immediately, and specifically operative as follows:

- **Provision 1:** For the purchase of a qualified principal residence made on or after March 1, 2009, and before July 3, 2009, and any purchase of a qualified principal residence on or after the effective date of this provision and before July 1, 2010.

- **Provision 2:** For purchases of a principal residence on or after the date upon which all tax credits have been allocated pursuant to provision 1 and before January 1, 2011.

POSITION

Pending.

Board Position:			Department Director	Date
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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.

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.

The Worker, Homeownership and Business Assistance Act of 2009 (Public Law 111-92)

The deadline to qualify for the "first-time homebuyer" credit was extended from November 30, 2009, to April 30, 2010. Additionally, if a buyer enters into a binding contract by April 30, 2010, the buyer has until June 30, 2010, to settle on the purchase. The new law also provides a "long-time resident" credit of up to $6,500 to others who do not qualify as "first-time homebuyers." To qualify, a buyer must have owned and used the same home as a principal or primary residence for at least five consecutive years of the eight-year period ending on the date of purchase of a new home as a primary residence. For homes purchased in 2009, the credit does not have to be paid back unless the home ceases to be the taxpayer's main residence within a three-year period following the purchase.

[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.

For all qualifying purchases in 2010, taxpayers have the option of claiming the credit on either their 2009 or 2010 tax returns.

STATE LAW

Current law 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 Franchise Tax Board (FTB) certification that the residence has never been previously occupied.

The maximum tax credit is allowed by the FTB is $100 million. Upon receipt of certification from the seller, the credit is allocated on a first-come, first-serve basis by the FTB. The credit must be claimed on a timely filed original return. The determination by the 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.

PROGRAM BACKGROUND

As of July 3, 2009, the FTB stopped accepting new home credit applications and as of August 31, 2009, the entire $100 million in principal residence credits had been allocated.

THIS BILL

Provision 1: Extend the Principal Residence Credit

This provision would allow the credit to be allocated to taxpayers who purchase a qualified principal residence on or after March 1, 2009, and before July 3, 2009. This provision would also allow a credit to be allocated for taxpayers who purchase a qualified principal residence on or after the effective date of the provision and before July 1, 2010, subject to the $100 million limit on the amount of credit that may be allocated, as revised.

This provision would define “qualified principal residence” as a single-family residence, whether detached or attached, that is purchased to be a principal residence for the minimum of two years as follows:

- For purchases made on or after March 1, 2009, and before July 3, 2009, a previously unoccupied residence.

- For purchases made on or after the effective date adding this provision and before July 1, 2010, a residence without regard to whether previously occupied.

This provision would clarify those taxpayers who purchased a qualified principal residence prior to July 3, 2009, and after the date of enactment of this provision but before July 1, 2010, would be allocated the credit if the certification was submitted to the FTB within one week after the close of escrow.

In addition, this provision would require for each certification received from the seller the total amount of credit available for allocation be reduced by 70 percent of the credit allocated to the taxpayer. The credit may be allocated if the qualified principal residence was purchased prior to July 3, 2009, and the taxpayer submitted their certification for the principal residence credit within one week before or after the close of escrow but not later than July 2, 2009.

For example, under this provision the 70 percent rate would be applied as follows, a taxpayer could be allocated a $10,000 credit, but the total amount of credits available for allocation would be reduced by 70 percent of the credit allocated, or $7,000. Under this provision, additional taxpayers could be allocated the credit.

Provision 2: Enact a New Principal Residence Credit

This provision would allow a tax credit for taxpayers who purchase a qualified principal residence on or after the date upon which all tax credits have been allocated pursuant to Revenue and Taxation Code section 17059, as amended by provision 1 above, and before January 1, 2011.

This provision would allow the credit to be applied in equal amounts for each of the three successive taxable years beginning with the taxable year in which the purchase of the qualified principal residence is made.

Under this provision, an individual taxpayer would be allowed one credit for the purchase of one qualified principal residence.

This provision would define "qualified principal residence" as a single-family residence, whether detached or attached, that is purchased to be the principal residence of the taxpayer for a minimum of two years and is eligible for the homeowner's exemption.[2]

This provision would deny the credit if the taxpayer fails to submit with his or her return certification by the seller that the residence was purchased by the taxpayer. The seller is required to provide the certification to the taxpayer and the FTB within one week after the close of escrow. If the taxpayer does not occupy the qualified principal residence for at least two years immediately following the purchase, the credit would be canceled, and the taxpayer would be liable for any credit allowed on previous tax returns.

[2] California Revenue & Taxation Code (CR&TC) section 218, a homeowner's property tax exemption is $7,000 of the full value of the dwelling.

Under this provision, taxpayers 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 the FTB certification that the taxpayer and seller have entered into the agreement on or after the date upon which all tax credits have been allocated pursuant to provision 1, and before January 1, 2011. The FTB would be required to conditionally reserve the credit upon receipt of the certification. The conditional reservations should be issued on a first-come-first-serve basis.

This provision would equally apportion the credit between two married taxpayers filing separately. For two or more taxpayers who are not married and purchase a qualified principal residence, the amount of the credit allowed would be allocated among the taxpayers in the same manner as each taxpayer's percentage of ownership, but the total allocated credit may not exceed $10,000.

The total credit that would be allowable is limited to $200 million. For each certification received from a seller, the total remaining amount of credit available for allocation would be reduced by an amount equal to 70 percent of the credit allocated to the taxpayer.

Upon receipt of certification of purchase from the seller, the FTB would allocate the credit based on a first-come, first-serve basis. The credit must be claimed on a timely filed original return. The determination by the 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 $200 million limitation would be treated as a mathematical error and any tax resulting from such disallowance may be assessed in the same manner as applicable to mathematical errors. Any disallowance may not be protested or appealed.

The FTB may prescribe rules, guidelines, or procedures necessary or appropriate to administer the credit. Those rules, guidelines, and procedures are exempt from provisions of the Administrative Procedures Act regarding regulations.

The credit would not be a business credit for purposes of the 50 percent business-credit limitations.[3]

This provision would remain in effect until December 1, 2014, and as of that date would be repealed.

This bill includes language to request an appropriation of $44, 000.

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[3]CR&TC section 17039.2 limits the amount of allowable "business credits" to an applicable amount. "Applicable amount" is equal to 50 percent of the tax before the application of any credits. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed.

IMPLEMENTATION CONSIDERATIONS

Provision 1: Extend the Principal Residence Credit

Implementing this provision would require some changes to existing tax forms and instructions and information systems. Please see the “fiscal impact” discussion below.

Provision 2: Enact a New Principal Residence Credit

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 provision uses terms that are undefined, “conditionally reserve” and “agreement.” It is unclear what the conditions would be to reserve the credit under which the credit would be reserved but not allocated. There is also ambiguity as to the type of “agreement” sufficient for conditional reservations that the taxpayer and seller would be required to jointly signed and submit to the FTB. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

This provision would allow a taxpayer to conditionally reserve a credit prior to the close of escrow. If a taxpayer conditionally reserves a credit prior to the close of escrow, it is unclear whether this would reduce the remaining available credit. It is unclear how or when the department would be notified if the taxpayer cancels escrow. In addition, the provision fails to specify how the department would handle the cancellation. For example, a taxpayer reserves a credit prior to the close of escrow; the taxpayer cancels escrow and fails to notify the FTB. Because of the reservation, a portion of the $200 million would have been allocated and would not be available for taxpayers that close escrow in the future. To ease administration of this provision, it is recommended that the provision be amended to require the taxpayer to notify the FTB within a specified timeframe of a delay or cancellation. If the taxpayer does not notify the department within a specified timeframe, the department would automatically cancel the reservation.

TECHNICAL CONSIDERATIONS

Amendment 1 has been provided to correct a technical error.

LEGISLATIVE HISTORY

AB 765 (Caballero/Solorio, 2009/2010) would have allowed a maximum credit of $10,000 for the purchase of a qualified principal residence, subject to a $100 million allocation cap. The bill would require that for each certification received from the seller the total amount of credit available for allocation would be reduced by 70 percent of the credit allocated to the taxpayer. This bill failed passage out of the Senate Revenue and Taxation Committee.

ABX8 34 (Jefferies, 2009/2010) and SBX8 21 (Ashburn, 2009/2010) are identical to each other and would extend the principal residence credit for purchases on and after May 1, 2010 and on or before December 31, 2010. These bills would expand the definition of “qualified principal residence” to include a residence that has never been occupied and first-time homebuyers. In addition, increase the credit allocation limit to $200 million. ABX8 34 is located in the Assembly Rules Committee; SBX8 21 is in the Senate Revenue and Taxation Committee.

SB 49 (Dutton, 2009/2010) would have extended the cease operative date for the Principal Residence Credit from December 1, 2010 to 12 months after the effective date of the bill. This bill would also eliminate the $100 million cap and that the credit would be allocated on a first-come first-serve requirement. This bill failed passage out of the Senate Revenue and Taxation Committee by the constitutional deadline.

SB 913 (Calderon, 2009/2010) contains similar provisions to this bill, however, SB 913 only applies to purchases of principal residences that have never been occupied. SB 913 is currently in its first reading in the Senate Revenue and Taxation Committee.

SBX6 3 (Calderon, 2009/2010) is identical to this bill. SBX6 3 is currently in its first reading in the Assembly Rules Committee.

SBX6 4 (Ashburn, 2009/2010) is similar to ABX8 34 (Jeffries, 2009/2010) and SBX8 21 (Ashburn, 2009/2010), however, SBX6 4 allows the taxpayer to enter into an enforceable contract by December 31, 2010, for purchases on or after December 31, 2010, and before August 1, 2010. SBX6 4 is currently on suspense 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 was fully allocated by the FTB on July 3, 2009, 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

Implementing this bill would require the FTB to create a new process within existing systems to conditionally reserve the credit and allocate credits when the seller submits a certification that the qualified principal residence sold. The FTB would be required to update forms and change systems to account for the credit. The FTB estimates the costs to the department to implement this bill would be approximately $1.1 million (11 PYs). If this bill is enacted without funding, the department would be required to redirect resources, which would have an adverse impact on current revenue generating programs and procedures.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SBX8-39 Principal Residence Credit Provision 1: Effective for Purchases On or After March 1, 2009 and Before July 3, 2009 (and for Purchases On or After the Effective Date of this Provision and Before July 1, 2010) Provision 2: Effective for Purchases On or After the Date Upon Which all Tax Credits Have Been Allocated Pursuant to Provision 1 and Before January 1, 2011 Enactment Assumed After April 1, 2010 ($ in Millions)			
2009-10	2010-11	2011-12	2012-13
-$4.1	-$90	-$75	-$60

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SBX8 39
As Introduced February 8, 2010

Amendment 1

On page 6, line 24 strike out "allowed" and insert:

allocated