Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Dutton	Analyst:	Angela Raygoza	Bill Number:	SB 49
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	January 13, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Qualified Residence Purchase Credit

SUMMARY

This bill would provide a tax credit for the purchase of a qualified principal residence.

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 made on or after March 1, 2009, and before March 1, 2010.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

During 1975, when the economy experienced its sharpest decline since the 1930's, federal legislation enacted the Tax Reduction Act of 1975, which included a homebuyer's credit. A tax credit was allowed for individuals that purchased a home (both new and old) or constructed a home as their principal residence. The amount of the credit was the lesser of $2,000 or 5% of the home's purchase price. The credit was repealed January 1, 1976.

Board Position:			Department Director	Date
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In 2008, a "first-time homebuyers" credit[1] was enacted under The 2008 Housing Act. This act added a new refundable tax credit for "first-time homebuyers." The amount of the credit is the lesser of $7,500 or 10% of the home's purchase price. The credit is phased out for taxpayers with adjusted gross income[2] (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 IRC 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.

Existing federal and state 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.

THIS BILL

This bill would provide a credit under the Personal Income Tax Law (PITL) to an individual who is a purchaser of a qualified principal residence. The amount of the credit would be equal to a portion of the purchase price of the residence, not to exceed $10,000. The bill would require that the credit be equally divided among three taxable years, beginning with the taxable year in which the purchase of the residence is made.

The credit would be allowed for one purchase of a qualified principal residence by an individual and would apply to purchases made on or after March 1, 2009, and before March 1, 2010.

This bill defines "qualified principal residence" as a new or previously unoccupied single-family residence, whether detached or attached, that is purchased to be the principal residence of the purchaser for a minimum of one year.

Under this bill, a credit would be disallowed unless the taxpayer submits certification by the seller of the residence that the residence is a new or previously unoccupied single-family residence.

This bill would allow the credit to be disallowed and recaptured, in accordance with rules established by the Franchise Tax Board, if the individual fails to occupy the qualified principal residence as his or her principal residence for at least one year during the period this bill is in effect–up to December 1, 2013.

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[1] Internal Revenue Code (IRC) section 36 allows a refundable credit for "first-time homebuyers".
[2] Adjusted Gross Income as defined by IRC 62 means gross income minus deductions.

Under this bill, for two married individuals filing separately, the credit would be applied to each individual by substituting $5,000 for $10,000. If two or more individuals who are unmarried purchase a qualified principal residence, the amount of the credit allowed would be allocated among the individuals in the same manner as each individual's percentage of ownership, except the total amount of the credit allowed could not exceed $10,000.

This credit would be repealed as of December 1, 2013.

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 terms that are undefined, "new" and "previously unoccupied." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill would require the purchaser to occupy the residence for a minimum of one year within the period that the legislation is in effect. From discussions with the author's office, this bill is inconsistent with the author's intent where the purchaser would be required to occupy the home within one year of purchase and occupy the home for a minimum of one year. It is also unclear how the one year occupancy rule should be applied if the one year occupancy rule is for a continuous one year period or if it can be broken into segments. It is recommended the author amend the bill to clarify the intent in order to avoid confusion by taxpayers.

In addition, the bill is unclear if the $10,000 credit applies to individuals and to married individuals filing joint. If two married individuals purchase the same residence, the language could be interpreted to allow each married person a credit of $10,000 for a total of $20,000. It is recommended the author amend the bill to clarify the intent in order to avoid confusion by taxpayers.

It is unclear whether the author intends for FTB's recapture rules to include circumstances where recapture would not occur. The language as written indicates FTB would prescribe the manner of recapture rather than circumstances when recapture would and would not occur. It is recommended the author amend the bill to describe circumstances where recapture is reduced or waived and allow FTB to clarify those circumstances.

TECHNICAL CONSIDERATION

This bill specifies that a credit would be disallowed unless the taxpayer submits certification by the seller. Generally, FTB requires taxpayers to provide certification upon request to eliminate additional processing and storage issues. It is recommended that the bill be amended to require the certification only upon request. Department staff is available to work with the author's office in order to resolve this concern.

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

This bill requires a taxpayer to submit certification of the "qualified principal residence," with the tax return. As a result, this bill could increase the department costs for processing and storage of the additional paperwork. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and, if necessary, an appropriation will be requested.

ECONOMIC IMPACT

Revenue Estimate

This proposal would result in the following revenue losses beginning in taxable year 2009:

Estimated Revenue Impact of SB 49 Effective for purchases made on or after March 1, 2009, and before March 1, 2010 Enactment Assumed After June 30, 2009 ($ in millions)		
2009-10	2010-11	2011-12
-$27	-$28	-$24

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. The home must serve as a primary residence and be purchased on or after March 1, 2009 and before March 1, 2010.

Based on historical data from the California Builder's Association for 2008 and using the Department of Finance's growth projections for new home sales, it is estimated that approximately 27,000 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 would be reduced by 5% to 25,650 [27,000 x (1- 5%)]. Because qualified purchases are limited to those made after March 1, 2009, total sales for 2009 would be reduced by 17% (2 months /12 months) to 21,300 [25,650 x (1-17%)]. Using the same methodology and reducing the figures to reflect purchases made by March 1, 2010, qualified purchases for taxable year 2010 are approximately, 6,000 (38,631 new home sales projection for 2010 x 95% to exclude investments x 17% to include only Jan and Feb. purchases).

To determine the value of credits generated and used, taxpayers with no tax liability were excluded. Tax data for individuals who reported the mortgage interest deduction for tax year 2005 was analyzed finding that approximately 75% of these filers had a tax liability. Applying this statistic to the estimate of qualified purchases for taxable year 2009, it is assumed that 15,975 (21,300 x 75%) purchasers would have a tax liability. Applying the credit limitation of $10,000, generated credits would total approximately, $160 million (15,975 x $10,000).

Starting with the tax year of the purchase, SB 49 would require that no more than one-third of credits generated be used in each of the three taxable years. For taxable year 2009, this reduces available credits for use to approximately $53 million ($160 million / 3 years). Of this $53 million, it is assumed that taxpayers would have sufficient tax liability to use 40% of the available credits in each year. The revenue loss from 2009 purchases is estimated to be approximately $21 million ($53 million x 40%) per year for three years and $6 million per year for three years for purchases in 2010. 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 credits used to reduce tax year 2009 liabilities and reduced estimated payments for tax year 2010 liabilities.

POLICY CONCERNS

This bill lacks carryover language. As a result, a taxpayer that is unable to use the entire amount of the credit in each of the three years would lose any unused portion of the credit. The author may wish to add language allowing a limited carryover period.

LEGISLATIVE STAFF CONTACT

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