ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Calderon	Analyst:	Dawn Hadid	Bill Number:	SB 1168
Related Bills:	See Legislative History	Telephone:	845-3391	Introduced Date:	February 22, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Principal Residence Credit

SUMMARY

This bill would provide a tax credit to an individual who purchases a qualified principal residence.

RECOMMENDATION

No position.

REASON FOR THE BILL

It appears the purpose of the bill is to encourage sales of newly constructed single-family residences and increase the number of people owning homes.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for purchases of qualified residences that occur on or after January 1, 2012, and before January 1, 2013.

ANALYSIS

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.

<u>FEDERAL LAW</u>

<u>First-Time Home Buyer's Credit (FTHBC)</u>

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

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

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[1] Adjusted Gross Income as defined by IRC section 62 means gross income minus deductions.

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The credit was recaptured under the terms of Internal Revenue Code 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 was sold before the 15-year period ends, the remaining credit must be recaptured in the year of sale. This law had a sunset date of September 30, 2011.

American Recovery and Reinvestment Act of 2009

The FTHBC was modified by the American Recovery and Reinvestment Act of 2009. In general, for homes purchased before December 1, 2009, the maximum credit was increased to $8,000 ($4,000 for a married individual filing separately), the credit was no longer recaptured unless the taxpayer sold the home within 36 months, and the credit could apply to homes that are financed by exempt mortgage revenue bonds or located in the District of Columbia.

The FTHBC had a sunset date of September 30, 2011.

STATE LAW

State tax law provided a credit under the Personal Income Tax Law (PITL) to an individual who was a purchaser of a qualified principal residence in an amount equal to the lesser of 5 percent of the purchase price or $10,000. The credit was allowed for purchases made on or after May 1, 2010, and on or before December 31, 2010. This law also allowed a credit for purchases occurring on or after December 31, 2010, and prior to August 1, 2011, but only if an enforceable contract to purchase the residence was executed by December 31, 2010.

The law required that the credit be claimed in equal amounts over three taxable years, beginning with the taxable year that the purchase of the residence is made.

The total credit available was limited to $200 million and was allocated in the amounts of $100 million for purchases of qualified principal residences that had never been occupied and $100 million for purchases by first-time home buyers.

This law remains in effect until December 1, 2014, and will be repealed as of that date.

PROGRAM BACKGROUND

The Franchise Tax Board (FTB) received 35,100 applications for the FTHBC and 22,100 applications for the New Home Credit.

As of March 24, 2011, the FTB had completely allocated the $100 million authorized to the FTHBC.

While $100 million was authorized for the New Home Credit, $94.3 Million of this amount was allocated. There was a balance remaining because the credit was only available for buyers who closed escrow on or before July 31, 2011, and sent applications to the FTB within 14 days after escrow closed. In addition, new homes closing escrow in 2011 were only eligible for the New Home Credit if the home had been purchased pursuant to an enforceable contract executed on or before December 31, 2010.

THIS BILL

This bill would provide a tax credit under the PITL to an individual who is a purchaser of a qualified principal residence in an amount equal to the lesser of 5 percent of the purchase price or $10,000. The credit would be allowed for purchases made on or after January 1, 2012, and on or before December 31, 2012. This bill would require an enforceable contract to be executed on or before December 31, 2012.

The bill would require that the credit be claimed in equal amounts over three taxable years, beginning with the taxable year that the purchase of the residence is made.

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

This bill would define the following:

- "Qualified principal residence" means a single-family residence, whether detached or attached, that is purchased to be the principal residence of the taxpayer, is eligible for the home exemption, and has either never been occupied or is purchased by a first-time home buyer.[2]
- "First-time home buyer" means any individual, or individual's spouse, who had no present ownership interest in a principal residence during the preceding three-year period ending on the date of the purchase of the qualified principal residence.

Under this bill, taxpayers would be allowed to reserve a credit prior to the close of escrow for the purchase of a qualified principal residence that has never been occupied. To reserve a 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 an enforceable contract on or after January 1, 2012, and on or before December 31, 2012. Upon receipt of the certification, the FTB would be required to notify the taxpayer that the credit has been reserved. The reservation of a credit is required to be canceled if a taxpayer fails to provide both the settlement statement and certification of the qualified principal residence or a notification of cancellation before January 15, 2013.

This bill would allow a credit if the taxpayer submits to the FTB, within two weeks, after the date of purchase of the qualified principal residence, a copy of the properly executed settlement statement and either one of the following:

- Certification from the seller, made under penalty of perjury, that the residence has never been previously occupied, or
- Certification from the taxpayer, made under penalty of perjury, that he or she is a first-time home buyer.

This bill would specify that if the taxpayer fails to occupy the qualified principal residence for at least two years immediately following the purchase, the credit would be canceled, and any previously applied credit would be recaptured. The taxpayer would be liable for any increase in tax attributable to the recapture of any credit previously allowed under this section.

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

This bill 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 allocable would be limited to $200 million. The credit would be allocated $100 million for purchases of qualified principal residences that have never been occupied and $100 million for purchases by first-time home buyers.

This bill would require that for each certification or reservation received from a taxpayer, for the purchase of a qualified principal residence that has never been occupied or for a first-time home buyer, the total amount of credit available for allocation would be reduced by an amount equal to 70 percent and 57 percent, respectively.

For example, under this bill the 70 percent rate would be applied as follows: a taxpayer that purchased a home that has never been occupied 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.

When the credits allocated for principal residences that have never been occupied exceed the $100 million limit, the FTB would be required to establish a wait list for subsequently received certifications and reservations. The order of priority would be based on the date the certification or reservation was received by the FTB. Taxpayers on the wait list are required to be notified by the FTB no later than December 31, 2012, as to whether they have been allocated a credit and the amount allocated.

Under this bill, if the taxpayer is both a first-time home buyer and the purchaser of a residence that has never been occupied, the FTB would be required to allocate the credit from the $100 million for principal residences that have never been occupied.

Upon receipt of required certifications of a contract or a purchase and either no previous occupancy or qualification as a first-time home buyer from the buyer and/or 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, except for taxpayers that purchased a home that was never previously occupied who were allocated a credit from the wait list for a qualified principal residence that was purchased in the 2012 taxable year. Those taxpayers may claim the credit on an amended income tax return for the 2012 taxable year. 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 limitations each for principal residences that have never been occupied and first-time home buyers 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, 2015, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

This bill would disallow a credit unless a taxpayer provides to the FTB a copy of the properly executed settlement statement within two weeks after the date of purchase. Because this bill would allow credits for purchases made retroactively to January 1, 2012, based on the language of the bill, the FTB would be required to disallow requests for credits that are outside of the two week notification period. It is recommended that the bill be amended to allow adequate time for the taxpayer to get the necessary documentation to the FTB.

The bill fails to allow adequate time for the FTB to notify taxpayers on the wait list. Because the bill requires notification by December 31, 2012, and allows qualified purchases until December 31, 2012, along with the two week delivery time to the FTB, the FTB would be required to accept applications until January 14, 2013. It is recommended that the bill be amended to allow sufficient time for the FTB to process and notify taxpayers.

TECHNICAL CONSIDERATIONS

This bill would require qualified purchases to be made on or after January 1, 2012 and on or before December 31, 2012. As a result, an "enforceable contract" is unnecessary because the escrow documents are one and the same. The verbiage is redundant. The following amendments would resolve this concern.

Amendment 1
On page 1, line 5, strikeout "pursuant to an enforceable contract"

Amendment 2
On page 2, line 5, strikeout "that they have entered into an enforceable contract"

LEGISLATIVE HISTORY

AB 183 (Caballero and Ashburn, Ch. 12, Stats. 2010), was enacted to allow a tax credit to an individual who purchased a new home or a first-time home buyer who is a purchaser of a qualified principal residence in an amount equal to the lesser of 5 percent of the purchase price or $10,000. The credit was allowed for purchases made on or after May 1, 2010, and on or before December 31, 2010. This act required an enforceable contract to be executed by December 31, 2010, for purchases occurring on or after December 31, 2010, and prior to August 1, 2011. This bill was chaptered on March 25, 2010.

[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.

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

Costs to implement this bill are currently being developed, but it should be noted that the costs to implement the prior home buyer credit were $1.3 million.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 1168 For Taxable Years Beginning On or After January 1, 2012 Assumed Enactment By August 1, 2012 ($ in Millions)		
2012-13	2013-14	2014-15
-$34	-$43	-$42

SUPPORT/OPPOSITION

Support: none provided.

Opposition: none provided.

ARGUMENTS

Proponents: Some would argue that the Principal Residence Credit would increase spending and stimulate California's economy.

Opponents: Some would argue that this bill would decrease revenue for the state and add additional work loads.

POLICY CONCERNS

Tax credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. This bill would incentivize behavior that has occurred in the past. The inclusion of a prospective operative date may be appropriate to more fully act as an inducement for future action or behavior, rather than providing a benefit for action taken without regard to this credit.

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