ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Holden	Analyst:	Scott McFarlane	Bill Number:	AB 132
Related Bills:	None	Telephone:	845-6075	Introduced Date: Amended Date:	January 16, 2013 March 21, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: The California Hardship Outlays to Protect Mortgagor Equity (HOME) Act

SUMMARY

This bill would provide an exception to the 2½-percent additional tax that is imposed on early distributions from qualified retirement plans.

RECOMMENDATION

No position.

Summary of Amendments

As introduced on January 16, 2013, this bill would provide an exception to the additional tax on early distributions from qualified retirement plans, as discussed in this analysis.

The March 21, 2013, amendments made minor technical modifications to the bill.

REASON FOR THE BILL

The reason for the bill is to provide temporary tax relief to homeowners who are committed to staying in their home and to serve as an economic development tool to reduce the number of home foreclosures.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for distributions made in taxable years beginning on or after January 1, 2014, and before January 1, 2017.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

FEDERAL LAW

Qualified Retirement Plan Distributions

The phrase "qualified retirement plans" collectively refers to a qualified retirement plan under IRC section 401(a), a qualified annuity plan under IRC section 403(a), a tax-sheltered annuity under IRC section 403(b) (a "403(b) annuity"), an eligible deferred compensation plan maintained by a state or local government under IRC section 457 (a "governmental 457 plan"), or an individual retirement arrangement under IRC section 408 (an "IRA"). Distributions from such plans are generally included in income in the year distributed.

Additional Tax on Early Distributions from Qualified Retirement Plans

A taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death, or disability is generally subject to a 10-percent additional tax on the amount includible in income, unless an exception to the tax applies.[1] Among other exceptions, the 10-percent additional tax does not apply to distributions made to an employee who separates from service after age 55, distributions to individuals called to active duty, distributions that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary, distributions made for certain medical expenses, distributions made to first-time homebuyers, or to distributions made to unemployed individuals for health insurance premiums.

Acquisition Indebtedness

Acquisition indebtedness with respect to a principal residence generally means indebtedness incurred for the acquisition, construction, or substantial improvement of the principal residence of the individual that is secured by the residence. It also includes refinancing of such debt to the extent the amount of the refinancing does not exceed the amount of the indebtedness being refinanced.[2]

Whether a residence is an individual's principal residence depends on each individual's facts and circumstances. Generally, the residence where an individual lives for the majority of the time is considered his or her principal residence. Other factors that may be considered include the address used on a driver's license, automobile registrations, tax returns, and voter registration cards. A residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.[3]

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[1] Internal Revenue Code (IRC) section 72(t).

[2] IRC section 163(h)(3)(B).

[3] The term "principal residence" has the same meaning as the home-sale exclusion rules under IRC section 121. Refer to federal Treasury Regulation section 1.121-1 for the facts and circumstances used to determine "principal residence."

CALIFORNIA LAW

Qualified Retirement Plans

California generally conforms to the federal rules that apply to qualified retirement plans without regard to taxable year to the same extent as applicable for federal income tax purposes.[4]

Additional Tax on Early Distributions from Qualified Retirement Plans

California conforms to the federal additional tax on early distributions from qualified retirement plans without regard to taxable year to the same extent as applicable for federal income tax purposes, modified to provide that the California additional tax is 2½ percent of the amount includible in income rather than the federal rate of 10 percent.[5]

Acquisition Indebtedness

California generally conforms to the federal rules relating to acquisition indebtedness and principal residence as of the "specified date" of January 1, 2009.[6]

THIS BILL

This bill would provide an exception to the 2½-percent additional tax that is imposed on early distributions from qualified retirement plans for the first $6,000 distributed to an individual who owes more on his or her principal residence than it is worth (or has a spouse that owes more on his or her principal residence than it is worth), and who uses the distribution to pay the interest or principal of acquisition indebtedness of such residence (or to pay as part of a loan modification that reduces the principal or interest of acquisition indebtedness of such residence), if all of the following conditions are met:

1. The distribution is made in taxable years beginning on or after January 1, 2014, and before January 1, 2017.
2. The individual uses the distribution to pay acquisition indebtedness interest or principal (either directly or as part of a loan modification) with respect to the principal residence of the taxpayer or the taxpayer's spouse within 60 days after the distribution is received.
3. The individual (or the individual's spouse) only owns one home, and that home is used as his or her principal residence.

[4] Revenue and Taxation Code (R&TC) sections 17501 and 17551.

[5] California generally conforms to IRC section 72, relating to the additional tax on early distributions from qualified retirement plans, as of the "specified date" of January 1, 2009, in R&TC section 17081, with modifications in R&TC section 17085; specifically, R&TC section 17085(c) provides that the additional tax on early distributions from qualified retirement plans under IRC section 72(t) is modified to provide that the early-distribution tax is 2½ percent of the amount includible in income rather than the federal rate of 10 percent, and such modified additional tax applies as applicable for federal income tax purposes for the same taxable year.

[6] R&TC section 17201.

The aggregate amount of distributions eligible for the exception to the 2½-percent additional tax for all three taxable years could not exceed $6,000 and would be limited to the acquisition indebtedness with respect to only one principal residence. The Franchise Tax Board would be authorized to promulgate regulations as necessary or appropriate to carry out the bill's purpose.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs or operations.

OTHER STATES' INFORMATION

The states surveyed for tax treatment of early distributions include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

A review of these states' laws found that *Illinois* generally exempts retirement plan contributions and distributions from gross income, and does not impose an additional tax on early distributions. *Massachusetts* does not allow tax-deferred retirement plan contributions, thus such distributions are not taxable until the full amount of the taxpayer's contributions that were previously subject to *Massachusetts* taxes are recovered, and there is no additional tax on early distributions. *Michigan* and *Minnesota* generally follow the federal rules that apply to retirement plan contributions and distributions, but do not impose an additional tax on early distributions. *New York* generally follows the federal rules that apply to retirement plan contributions and distributions, except that an individual who has reached the age of 59½ may exclude up to $20,000 of certain pension distributions to the extent the payments are includible in federal gross income and not otherwise excluded as government pension payments, and there is no additional tax on early distributions. *Florida* does not impose personal income tax; thus, a comparison to *Florida* is not applicable.

FISCAL IMPACT

This bill would require some changes to existing tax forms and instructions and information systems. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 132 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 ($ in Millions)			
Fiscal Year	2013-14	2014-15	2015-16
Amount	+ $4.9	+ $4.0	+ $1.8

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

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

ARGUMENTS

Proponents: Proponents may argue that this bill would provide financial relief to individuals who are struggling to stay in their homes and would reduce the number of unoccupied homes that negatively impact home values of neighborhoods and communities.

Opponents: Opponents may argue that this bill would result in an unwise use of retirement savings because the early distributions from qualified retirement plans would still be subject to the federal 10-percent additional tax.

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