Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Stone	Analyst:	Funmi Obatolu	Bill Number:	SB 1149
Related Bills:	See Legislative History	Telephone:	845-5845	Introduced Date:	February 18, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Individual Homeownership Savings Account / Deduction /Exclusion

SUMMARY

Under the Personal Income Tax Law, this bill would create an “individual home ownership savings account” (Homeownership Account) that would provide certain income tax benefits similar to an individual retirement account (IRA).

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to encourage and promote individual homeownership.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2017.

FEDERAL/STATE LAW

IRAs

Federal law provides for two types of IRAs: traditional IRAs and Roth IRAs. In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Contributions to a traditional IRA are limited; for 2015, contributions are limited to the smaller of $5,500 ($6,500 if age 50 or older), or the taxpayer’s taxable compensation for the year.

A taxpayer that receives a distribution from a traditional IRA prior to age 59 1/2, or as a result of death, or disability, is generally subject to a 10-percent additional tax on the amount includable in income for federal purposes, unless an exception to that additional tax applies. Among other exceptions, the 10 percent additional tax does not apply to a onetime distribution of up to $10,000 made to first-time homebuyers for the qualified acquisition cost of a residence.

California law automatically conforms to the federal rules that apply to traditional IRAs, except that the additional tax on nonqualified distributions is modified to be 2.5 percent for California purposes instead of the federal 10 percent rate.

Itemized Deductions

Under federal law, an individual may elect to claim his or her itemized deductions for a taxable year in lieu of the standard deduction. Itemized deductions generally are those deductions which are not allowed in computing adjusted gross income (AGI). Itemized deductions include unreimbursed medical expenses, investment interest, casualty and theft losses, wagering losses, charitable contributions, qualified residence interest, state and local income taxes (or in lieu of income, sales taxes), property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses that are only deductible to the extent that they exceed 2 percent of AGI. Additional limitations apply to high-income taxpayers.

California generally conforms to the federal rules that apply to itemized deductions.

THIS BILL

For each taxable year beginning on or after January 1, 2017, this bill would allow qualified taxpayers to create a Homeownership Account. The income earned and the requirements and limitations on the Homeownership Account, except as provided in this bill, would receive the same treatment as a traditional IRA. California gross income would not include any income accruing during the taxable year, and the qualified taxpayer's annual contribution to the Homeownership Account would be deductible, as specified.

A deduction would be allowed for contributions to a Homeownership Account as a miscellaneous itemized deduction subject to the 2 percent of AGI floor limitation, not to exceed the following amounts:

- Thirty thousand dollars ($30,000) for a qualified taxpayer who is married filing a joint return, head of household, and surviving spouses.
- Fifteen thousand dollars ($15,000) in the case of a qualified taxpayer filing a return that is not a joint return, head of household, or surviving spouse status.

"Qualified taxpayer" would mean 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 principal residence. A qualified taxpayer's gross income per taxable year could not exceed the following amounts:

- $100,000 for a qualified taxpayer who is married filing a joint return, head of household, or a surviving spouse.
- $50,000 for a qualified taxpayer filing return that is not a joint return, head of household, or surviving spouse status.

The Franchise Tax Board would be required to annually adjust the amount of gross income by the Consumer Price Index beginning with the 2017 taxable year.

Any amount withdrawn from a Homeownership Account would be included in the income of the payee or distributee for the taxable year in which the payment or distribution is made, unless the payment or distribution is used to pay for the individual homeownership savings expenses of a qualified taxpayer who established the account.

The bill would define a Homeownership Account as a trust that meets all of the following requirements:

- Is designated as a Homeownership Account by the trustee.
- Is established for the exclusive benefit of any qualified taxpayer establishing the account where the written governing instrument creating the account provides that 1) all contributions to the account be in cash, and 2) the account is established to pay for the qualified individual home ownership savings expenses of a qualified taxpayer establishing the account.
- Is, except as otherwise specified, subject to the same requirements and limitations as an IRA established under IRC section 408.
- Is the only Homeownership Account established by the qualified taxpayer.

This bill also would define the following terms and phrases:

- “Qualified individual home ownership development expenses” means expenses, including a down payment or mortgage payment, paid or incurred in connection with the purchase of a qualified taxpayer’s principal residence in California for use by that taxpayer who established the Homeownership Account.
- “Trustee” would have the same meaning as under IRC section 408, relating to retirement accounts and any regulations adopted thereafter.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

Except as otherwise required or authorized by this bill, all requirements and limitations that apply to a traditional IRA under IRC section 408 would apply to a Homeownership Account. Those requirements and limitations include rules for the treatment of contributions to and distributions from a traditional IRA (e.g., IRC section 72(t), which imposes a 10 percent additional tax on early distributions from qualified retirement plans, and IRC section 219, which limits contributions to a traditional IRA). To insure consistency with the author’s intent, it is suggested that the bill be amended to specify the subdivisions of IRC section 408 and other provisions of the IRC applicable to IRAs that would apply to a Homeownership Account established pursuant to this bill.

It is unclear whether a qualified taxpayer that sells or ceases to occupy the property as a principal residence would be required to report the previously untaxed distributions? If yes, under what circumstances?

Because the definition of "qualified taxpayer" would include any individual or individual's spouse, each spouse would be eligible to establish a Homeownership Account and take advantage of the tax benefits this bill would provide. If this is contrary to the author's intent, this bill should be amended.

TECHNICAL CONSIDERATIONS

The department has identified the following technical considerations and is available to work with the author's office to resolve these and other concerns that may be identified.

- The phrase "qualified individual home ownership development expenses" is defined in the bill, but not used elsewhere in the bill, while the term "individual homeownership savings expenses" is used in this bill but not defined. The bill should be amended to provide consistency.
- For internal consistency and harmony within the Revenue and Taxation Code, the phrase "a qualified taxpayer who is married filing a joint return" should be amended to read, "qualified taxpayers filing a joint return," and the term "principal residence" should be followed by the phrase "within the meaning of Section 121 of the Internal Revenue Code."
- The annual adjustment, or indexing, of gross income would begin the first year that this bill would be operative. Generally indexing begins with the second year a provision is operative. For consistency, the bill should be amended to begin indexing in 2018.

LEGISLATIVE HISTORY

AB 1164 (Bogh, 2005/2006) and AB 1573 (Garcia, 2005/2006) would have created an individual homeownership development account that would have included income tax benefits similar to an IRA. AB 1164 and AB 1573 failed to pass by the constitutional deadline.

SB 553 (Dutton, 2005/2006) would have created an individual homeownership development account that would have included income tax benefits similar to an IRA. SB 553 failed to pass out of the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed 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.

Florida does not have a personal income tax.

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a deduction comparable to the deduction allowed by this bill.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1149 As Introduced February 18, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19*
$0.0	- $80	- $160

*The revenue loss is expected to grow at a rate of $50 million per year indefinitely. This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Although the bill would be operative for taxable years beginning on or after January 1, 2017, financial institutions are not expected to be able to have the infrastructure ready until 2018. The California Association of Realtors reports that on average, 420,000 homes are sold in California every year. Research indicates that nearly 50 percent, or 210,000 homes, are sold to individuals who are either first-time home buyers or buyers who have not owned a home in the previous three years.

It is assumed that 80 percent of prospective home buyers that meet the income qualifications would open a Homeownership Account. Because purchasing a home requires several years of savings, it is assumed that taxpayers would quickly learn about the benefits of Homeownership Account contributions and begin contributing to the accounts several years before purchasing a principal residence. Taking into account the timing of home purchase plans, it is estimated that 260,000 accounts would be open by the end of 2018 and taxpayers would contribute an average of $18,000. The deduction is subject to the 2-percent miscellaneous itemized deduction floor and it is assumed that 75 percent of taxpayers would qualify for the deduction.

It is estimated that qualified taxpayers would make $3.5 billion in qualified contributions to their Homeownership Accounts in 2018. Contributions plus interest would grow at an average of $1 billion annually. Applying the average tax rate of 4 percent, the estimated revenue loss would be $140 million in 2018 and $210 million in 2020. It is assumed that taxpayers would continue to maintain the account for their lifetime. As a result, the revenue loss is expected to grow by an estimated $50 million per year in perpetuity. The tax-year estimate is converted to fiscal years, and rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION

Support: None Provided.

Opposition: None Provided.

ARGUMENTS

Proponents: Some may argue that this bill would encourage homeownership by allowing new homeowners to more easily plan and save money.

Opponents: Some may argue that California has several state and federal programs designed to assist homebuyers, as such the additional incentive provided under this bill would not increase or encourage homeownership.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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