Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Steinorth, et al	Analyst:	Funmi Obatolu	Bill Number:	AB 1736
Related Bills:	See Prior Analysis	Telephone:	845-5845	Amended Date:	April 21, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Homeownership Savings Account/Deduction/Exclusion

SUMMARY

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

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 21, 2016, amendments modified definitions and made other minor technical changes. Except for “This Bill,” “Implementation Considerations,” “Technical Considerations,” “Economic Impact,” and “Support/Opposition” sections, the remainder of the department’s analysis of the bill as amended March 10, 2016, still applies.

The “Fiscal Impact” and “Policy Concerns” sections have been restated for convenience.

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. 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 adjusted gross income (AGI) floor limitation, not to exceed the following amounts:

- Twenty thousand dollars ($20,000) for qualified taxpayers who are married filing a joint return, head of household, and surviving spouses.
- Ten thousand dollars ($10,000) in the case of a qualified taxpayer filing a return that is not a joint return, head of household, or surviving spouse status.

Any amount withdrawn from a Homeownership Account would be included in the income of the payee or distributee for the taxable year in which the payment or distribution is made,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 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 homeownership 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 Internal Revenue Code (IRC) Section 408.
- Is the only Homeownership Account established by the qualified taxpayer.
- Is established by a qualified taxpayer who has a gross income of 80 percent or less than the area median income.

This bill also would define the following terms and phrases:

- “Qualified homeownership development expenses” means expenses, including a down payment or closing costs 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.
- “Qualified taxpayer” means any individual, or individual’s spouse, who has never had an ownership interest in a principal residence subject to the contribution allowed by this bill.
- “Trustee” shall have the same meaning as under IRC section 408 relating to individual retirement accounts.

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 ensure 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.

The definition of a Homeownership Account would include a gross income limitation of 80 percent or less of area median income for a qualified taxpayer that establishes the account. Gross income is not a figure that appears on federal or state tax returns. To avoid confusion and for ease of administration, the author may want to consider replacing the reference to gross income with a reference to AGI, and specifying the years the AGI limitation would apply.

Additionally, the definition of Homeownership Account uses the undefined phrase “area median income.” The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill.

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 homeownership development expenses” is defined in the bill, but not used elsewhere in the bill, while the term “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 definition of “qualified taxpayer” should be amended to remove the phrase “subject to the contributions allowed by this section” to clearly limit the definition to individuals who have “never had an ownership interest in a principal residence.”

FISCAL IMPACT

The department’s costs to implement this bill have yet to be determined. As the bill moves through the legislative process and the implementation concerns are resolved, 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 AB 1736 As Amended April 21, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19
$0.0	- $90	- $130

The revenue loss is expected to level off in 2023 at approximately $80 million annually. 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 is 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 approximately 33 percent, or 140,000 homes, are sold to individuals who are first-time home buyers that meet the income qualifications specified in the bill. This estimate uses 80 percent of California's median income for the income limitation.

It is assumed that 80 percent of prospective home buyers 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 would 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 400,000 accounts would be open by the end of 2018 and taxpayers would contribute an average of $12,500, resulting in total estimated contributions of $5 billion. 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, resulting in an increase in itemized deductions of $3.8 billion.

It is estimated that contributions would earn interest of 4.5 percent annually and would grow at an average of $40 million annually. Applying the estimated average tax rate for qualified taxpayers of approximately 4 percent, the estimated revenue loss would be $160 million in 2018. It is assumed that taxpayers would continue to make contributions to the homeownership account until making a qualified purchase. As a result, the revenue loss is expected peak in 2018 and level off in 2023 at approximately $80 million dollars annually.

The tax year estimate is converted to fiscal years and rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION[1]

Support: California Association of Community Managers, California Association of Realtors, California Building Industry Association, California Counsel for Affordable Housing, California Credit Union League, County of San Bernardino, Education Community for Homeowners, Housing Authority of the County of San Bernardino, League of California Cities, Silicon Valley Leadership Group, Western Manufacturing Housing Communities Association.

Opposition: California Tax Reform Association.

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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[1] As noted in the Assembly Housing and Community Development Committee analysis dated April 18, 2016.