



## Analysis of Original Bill

Author: Steinorth

Sponsor:

Bill Number: AB 1758

Analyst: Davi Milam

Phone: (916) 845-2551

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Attorney: Bruce Langston

Related Bills: See Legislative  
History

**Subject:** Homeownership Savings Account/Exclusion

### Summary

Under the Personal Income Tax Law (PITL), this bill would create a “homeownership savings 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, 2018.

### 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 IRAs are limited; for 2017 and 2018, contributions are limited to the lesser 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, 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 one-time 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 regarding qualification that apply to 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.

Neither federal nor state law allows an exclusion similar to the one this bill would allow.

### **This Bill**

For taxable years beginning on or after January 1, 2018, this bill would, under the PITL, allow the creation of a homeownership savings account, as defined and would specifically exclude from gross income any income accruing during the taxable year to a homeownership savings account.

The bill would define a homeownership savings account as a trust that meets all of the following requirements:

- Is designated as a homeownership savings account by the trustee for the benefit of any person.
- Is established by a person, or persons who are spouses, where the written governing instrument creating the homeownership savings account provides that: 1) all contributions to the account be in cash, including refunds of taxes paid, and can be made by any person; and 2) the account is established to pay for the qualified homeownership savings expenses of the person who is the beneficiary of 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 savings account established by the person who established the account.
- The balance of the homeownership savings account does not exceed the maximum balance established for the account. "Maximum balance" of the homeownership account would mean 20 percent of the median home value within the state, as determined by the Department of Housing and Community Development (DHCD) as posted on its Internet Web site for the year the account is created.

This bill would require the DHCD to post the annual median home value before the first of an unspecified month in 2018, and each first of an unspecified month thereafter.

This bill also would define the following terms and phrases:

- "Person" means any individual, or individual's spouse, who has no present ownership interest in a principal residence within the meaning of IRC section 121, relating to exclusion of gain from sale of principal residence during the preceding three-year period ending either on the date the homeownership savings account is established or on the date the individual's, or individual's spouse's, purchase of the principal residence for which any amount is withdrawn from the homeownership savings account.

- “Qualified homeownership savings expenses” means expenses, including a down payment or closing costs paid or incurred, in connection with the purchase of a person’s principal residence within the meaning of IRC section 121, relating to exclusion of gain from the sale of principal residence, in this state for use by the person who is the beneficiary of the homeownership savings account.

“Trustee” shall have the same meaning as that term 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.

The definition of homeownership savings accounts as a trust generally subject to the requirements and limitations applicable to an IRA established under IRC section 408 may be overly broad. For example, such accounts would be able to invest cash contributions in any investment vehicle an IRA may invest in, including foreign or domestic real estate, precious metals, stock, pass-through entities, as well as more traditional interest-bearing investments such as government bonds and certificates of deposit. Additionally, the early distribution penalty and contribution limits applicable to IRAs would apply to homeownership savings accounts. For consistency with the author’s intent and to avoid conflicting requirements, this bill should be amended to specify the IRC’s IRA provisions applicable to homeownership savings accounts.

The bill lacks a deduction for contributions made to a homeownership savings account. If this is contrary to the author’s intent, the bill should be amended.

Principal residence within the meaning of IRC section 121 includes property other than a home or condominium, such as a houseboat or house trailer. If this is contrary to the author’s intent the bill should be amended.

Because the term “person” would mean an individual or the individual’s spouse, each spouse would be eligible to establish separate homeownership saving accounts. If this is contrary to the author’s intent, this bill should be amended.

The defined term “person” is used in multiple contexts, for example, the person establishing a homeownership saving account, the person that is a beneficiary of the homeownership saving account, and a person contributing to a homeownership saving account. Because the bill fails to specify otherwise, the beneficiary may be different from the person or persons establishing or contributing to the homeownership savings account. If the author intends the person establishing, contributing, and benefiting from the homeownership savings account be the same person, the bill should be amended.

The bill fails to specify which of the trigger dates, is controlling for purposes of determining whether an individual is a “person,” the date the homeownership savings account is established or the date principal residence is purchased?

The bill fails to specify whether the maximum account balance would be applicable for the year the homeownership savings account is created or periodically (annually for example). Further, it is unclear that the DHCD would be posting the annual median home value in advance of the tax year. The bill is silent on treatment of a homeownership savings account whose balance exceeds the maximum balance established for the account. For clarity and ease of administration, the bill should be amended.

The definition of “qualified homeownership savings expenses” is overly broad. For example, it could be argued that a cash purchase, closing costs, as well as expenses for repairs, renovations, the purchase of new appliances and soft goods (furniture and drapes), and moving expenses could be “paid or incurred in connection with the purchase of a qualified taxpayer’s principal residence.” Additionally, it could be argued that on-going mortgage payments would be qualified homeownership expenses because the bill fails to specify a cut-off date for expense paid or incurred in connection with a purchase. Further, the bill is silent on the treatment of previously excluded homeownership savings account income used to pay expenses other than “qualified homeownership savings expenses.” If this is contrary to the author’s intent, the bill should be amended.

Because the bill fails to specify otherwise, a homeownership savings account may remain open indefinitely, allowing contributions and the resulting tax benefits to continue in perpetuity.

### **Technical Considerations**

On page 1, line 4, subdivision (a) should be amended by replacing the term “accruing” with “earned” as most individual taxpayers use the cash-basis method rather than the accrual method of tax accounting.

### **Legislative History**

AB 1979 (Bonta, 2017/2018), similar to this bill, would create an individual homeownership savings account that would include income tax benefits similar to an IRA. AB 1979 is pending before the Assembly Housing and Community Development Committee.

AB 53 (Steinorth, et al., 2017/2018) would have created an individual homeownership savings account that would have included income tax benefits similar to an IRA. AB 53 failed to pass by the constitutional deadline.

AB 1736 (Steinorth, et al., 2015/2016), similar to this bill, would have created an individual homeownership savings account that would have included income tax benefits similar to an IRA. AB 1736 failed to pass by the constitutional deadline.

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 by the constitutional deadline.

### **Other States' Information**

*Illinois, Massachusetts, Michigan, Minnesota, and New York* laws do not provide tax benefits comparable to the tax benefits that would be allowed by this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

### **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**

#### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1758 as Amended January 4, 2018  
Assumed Enactment after June 30, 2018, (\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2018-2019	\$0
2019-2020	- \$0.2
2020-2021	- \$0.9

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, 2018, financial institutions are not expected to be able to have the infrastructure ready until 2020. Based on reports from the California and National Association of Realtors and Federal Reserve Economic Data, an average of 560,000 housing units are sold in California every year. Research indicates that nearly 38 percent, or 210,000 housing units, are sold to individuals who are first-time buyers.

It is assumed that 25 percent of prospective homebuyers would open a homeownership savings account. It is assumed that taxpayers would learn about the benefits of homeownership savings 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 50,000 homeownership savings accounts would be opened by the end of 2020 and taxpayers would contribute an average of \$7,150.

It is estimated that qualified taxpayers would make \$360 million in qualified contributions to their homeownership savings accounts in 2020 and have interest gains of \$7.7 million in 2020 and gains of \$200 million in 2025. Applying the average tax rate of 4 percent, the estimated revenue loss would be \$300,000 in 2020 and \$8 million in 2025. It is assumed that taxpayers would continue to maintain the homeownership savings account until a home is purchased.

The tax year estimates are converted to fiscal years and then rounded to arrive at the amounts shown in the above table.

### **Support/Opposition**

Support: None Provided.

Opposition: None Provided.

### **Arguments**

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

Opponents: Some may argue that this bill is unnecessary because there are existing state and federal programs designed to assist homebuyers.

### **Policy Concerns**

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. For example, the purchase of a new roof could be paid with income this bill would exclude from taxable income and the purchase price could be added to the home's basis.

This bill would allow the purchase of personal property with income excluded from tax.

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

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

**Legislative Staff Contact**

Davi Milam  
Legislative Analyst, FTB  
(916) 845-2551  
[your.name@ftb.ca.gov](mailto:your.name@ftb.ca.gov)

Jame Eiserman  
Revenue Manager, FTB  
(916) 845-7484  
[jame.eiserman@ftb.ca.gov](mailto:jame.eiserman@ftb.ca.gov)

Diane Deatherage  
Legislative Director, FTB  
(916) 845-6333  
[diane.deatherage@ftb.ca.gov](mailto:diane.deatherage@ftb.ca.gov)