



## Analysis of Original Bill

Author: Bonta	Sponsor:	Bill Number: AB 1979
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Attorney: Bruce Langston	Related Bills: See Legislative History	

**Subject:** Homeownership Savings Account/Deduction/Exclusion

### Summary

Under the Personal Income Tax Law, 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 each taxable year 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 includible 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 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 a deduction or an exclusion similar to the ones this bill would allow.

### *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 as of the specified date of January 1, 2015.<sup>1</sup>

### **This Bill**

For each taxable year beginning on or after January 1, 2018, this bill would allow qualified taxpayers to create a homeownership savings account. Gross income would not include any income accruing during the taxable year to a homeownership savings account, and the qualified taxpayer's annual contribution to the homeownership savings account would be deductible, as specified.

A deduction would be allowed for contributions to a homeownership savings 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 qualified taxpayers filing a joint, head of household, or surviving spouse (as defined in Section 17046) return. For qualified taxpayers whose AGI exceeds one hundred fifty thousand dollars (\$150,000) during the taxable year, the deduction allowed would be reduced by one dollar (\$1) for each four dollars (\$4) of AGI in excess of one hundred fifty thousand dollars (\$150,000).
- Fifteen thousand dollars (\$15,000) in the case of a qualified taxpayer filing a return other than as described above. For qualified taxpayers whose AGI exceeds eighty thousand dollars (\$80,000) during the taxable year, the deduction allowed would be reduced by one dollar (\$1) for each four dollars (\$4) of AGI in excess of eighty thousand dollars (\$80,000).

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<sup>1</sup> On December 22, 2017, President Trump signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act of 2017. Public Law (PL) 115-97. H.R. 1 modifies certain itemized deductions including the medical expense deduction and state and local tax deduction. The mandated report of federal income tax changes, including those made by PL 115-97 will be submitted to the Legislature by the April 20, 2018, deadline.

For each taxable year beginning on or after January 1, 2019, the deduction amounts would be annually adjusted by the Franchise Tax Board (FTB) in the same manner as the income tax brackets, except that the amounts would be adjusted to the nearest one hundred dollars (\$100).

Any amount withdrawn from a homeownership savings 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 within 120 days to pay for the qualified homeownership savings expenses of a qualified beneficiary.

This 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.
- Is established for the exclusive benefit of any qualified beneficiary establishing the account where the written governing instrument creating the account provides that: 1) all contributions to the account be in cash and made by any person; and 2) the account is established to pay, pursuant to the requirements and limitations in this section, for the qualified homeownership savings expenses of a qualified beneficiary.
- Is, except as otherwise specified, subject to the same requirements and limitations as an IRA established under Internal Revenue Code (IRC) section 408<sup>2</sup>, and regulations thereunder.
- A qualified beneficiary, which may be the qualified taxpayer, must be designated by April 15 of the year following the taxable year in which the account was established. The qualified beneficiary may be changed at any time, but only one qualified beneficiary may be designated for an account at any one time. Married spouses would qualify as one beneficiary.

This bill also would define the following terms and phrases:

- “Financial Institution” means a bank, bank and trust, trust company with banking powers, savings bank, savings association, or credit union organized under the laws of this state, any other state, or the United States; an industrial loan and thrift authorized to accept deposits or a money market mutual fund registered under the federal Investment Company Act of 1940 and regulated under Rule 2a-7, promulgated by the Securities and Exchange Commission under that Act.
- “Qualified beneficiary” means any individual or individual’s spouse, who has never had an ownership interest in a principal residence, within the meaning of Section 121 of the IRC, relating to the exclusion of gain from the 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 of the individual’s or individual’s spouse’s purchase of the principal residence for which any amount is withdrawn from the homeownership savings account.

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<sup>2</sup> Section 408 of the IRC, relating to individual retirement accounts.

- “Qualified homeownership “savings expenses” means a disbursement listed on a settlement statement for the purchase of a single-family residence by a qualified beneficiary, the down payment for that residence, and the costs of construction or financing the construction of a single-family residence.
- “Qualified taxpayer” means an individual who establishes, individually or jointly with one or more individuals, a homeownership savings account.
- “Single-family residence” means a single-family residence located in this state and owned and occupied by or to be occupied by a qualified beneficiary as the qualified beneficiary’s principal residence, which may include a manufactured home, trailer, mobile home, condominium unit, townhome, or cooperative.
- “Trustee” shall have the same meaning as that term under IRC section 408, relating to individual retirement accounts.

This bill would provide that an individual may:

- Jointly own a homeownership savings account with another person if the joint account holders file a joint return.
- Be the account holder of more than one homeownership savings account but shall not hold or own multiple accounts that designate the same qualified beneficiary.
- Be designated as the qualified beneficiary on more than one homeownership savings account.

The qualified taxpayer may not use the funds in the homeownership savings account to pay expenses of administering the account, other than a service fee that may be deducted from the account by the financial institution. The qualified taxpayer may withdraw funds, in whole or in part, from a homeownership savings account and deposit funds in another homeownership savings account held by a different financial institution or the same financial institution.

The qualified taxpayer would be required to submit to the FTB, in the form and manner required by the FTB, detailed information regarding the account, including the following:

- A list of transactions for the account during the taxable year.
- The Form 1099 issued by the financial institution for the account for the taxable year.
- A detailed account of the qualified homeownership savings account expenses for which account funds were withdrawn and expended.
- A statement of the amount of funds remaining in the account, if any.

This bill would require the FTB to establish a process for qualified taxpayers to notify the FTB of the homeownership savings account, the account holder or holders, transfers, and the qualified beneficiary. This information may be included on a qualified taxpayer’s tax return or any other means deemed appropriate by the FTB.

This bill also would specify that a financial institution is not required to take any action to ensure compliance with these provisions, including to designate an account, designate a qualified beneficiary, or report any information to the FTB or any other state agency unless otherwise required by law.

## 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.

Although the bill limits the contribution amount subject to deduction, unlike the rules governing excess contributions to IRAs, the bill lacks a clear and unambiguous limit on the total amount that may be contributed.

Because the term "qualified taxpayer" would mean an individual or the individual's spouse, it appears that both individuals would be eligible for the tax benefits this bill would allow. If this is contrary to the author's intent, this 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 "qualified beneficiary" the date the homeownership savings account is established or the date the principal residence is purchased?

The undefined phrase "a disbursement listed on a settlement statement" could be broadly interpreted. For example, a disbursement could include any charge that appears on the closing statement, including payment of tax liens, repairs, prepayment of taxes, and other items that may be unrelated to the residence, such as a credit card payoff. For clarity and ease of administration, it is recommended that the bill be amended.

The undefined phrase "costs of construction or financing of construction" could be broadly interpreted. For example, it could be argued that costs for repairs, renovations, the purchase of new appliances and soft goods (furniture and drapes) would qualify. Additionally, it could be argued that on-going mortgage payments would constitute "financing," and thus, be qualified homeownership expenses because the bill fails to specify a cut-off date for financing. 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.

The defined phrases “qualified taxpayer” and “qualified beneficiary,” and the undefined term “individual” are used inconsistently. It is recommended that the bill be amended for consistency of terminology and to clarify the relationship between the qualified taxpayer, qualified beneficiary, and the individuals that could generate a deduction to clearly express the author’s intent and prevent conflicts between taxpayers and the department.

Additionally, the defined term “trustee” and the defined phrase “financial institution” are used inconsistently. For example, the “trustee” must designate the account as a homeownership savings account; however, a “financial institution” is not required to take any action to ensure compliance with the bill’s requirements. It is recommended that the bill be amended for consistency of terminology and to clearly express the author’s intent.

Because the bill fails to specify a limited rollover period, a qualified taxpayer may “withdraw funds” for an indefinite period before redepositing the funds into another homeownership savings account. If this is inconsistent with the author’s intent the bill should be amended.

### **Technical Considerations**

On page 2, line 6, 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 accounting.

On page 4, line 21, after “residence” insert “within the meaning of Section 121 of the Internal Revenue Code,” for consistency of terminology.

### **Legislative History**

AB 1758 (Steinorth, 2017/2018), similar to this bill, would create an individual homeownership savings account. AB 1758 is pending before the Assembly Committee on Housing and Community Development.

AB 53 (Steinorth, et al., 2017/2018), similar to this bill, 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 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 out of the Senate Revenue and Taxation Committee.

### Other States' Information

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide tax benefits comparable to the tax benefits this bill would allow. 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.

### Economic Impact

#### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1979 as Introduced January 31, 2018  
For Taxable Years Beginning On or After January 1, 2018  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$0
2019-2020	- \$43
2020-2021	- \$54
2021-2022	- \$33

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

#### Revenue Discussion

The analysis assumes that to open a homeownership savings account, the qualified taxpayer has never owned a home and earns less than the maximum income allowed under the phase-out. The annual contribution deduction would be limited to \$15,000 for single and married filing separate taxpayers and \$30,000 for all other taxpayers. It is also assumed that once a home is purchased the account would be closed.

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 520,000 housing units are sold in California every year. Research indicates that nearly 40 percent, or 210,000 housing units, are sold to individuals who are first-time buyers.

It is assumed that 65 percent of prospective home buyers would open an individual homeownership savings account. It is assumed that taxpayers would quickly 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 140,000 homeownership savings accounts would be opened by the end of 2020 and taxpayers would contribute an average of \$21,000. In the first year, the average contribution amount is higher as people intending to buy a home in 2020 have amassed significant savings and contribute large amounts to take full advantage of the deduction. By 2025, the average contribution amount has fallen to an average of \$12,000. The deduction is subject to the 2 percent miscellaneous itemized deduction floor.

It is estimated that qualified taxpayers would make \$2.9 billion in qualified contributions to their homeownership savings accounts in 2020 and contributions plus interest would grow at an average of \$200 million annually. Applying the average tax rate of 4 percent, the estimated revenue loss would be \$75 million in 2020 and \$27 million in 2025. It is assumed that once a home was purchased the taxpayers would close the homeownership savings account.

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

### **Support/Opposition**

Support: Greenlining Institute (Sponsor).

Opposition: None Provided.

### **Arguments**

Proponents: Some may say that this bill would encourage homeownership by allowing new homeowners to more easily plan to 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 allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. For example, the cost of constructing a new home could be paid with income this bill would exclude from taxable income and the cost price could be added to the home's basis. Additionally, certain items on the settlement statement such as pro-rated property taxes and prepaid interest may be otherwise deductible, and could be paid with income this bill would exclude from taxable income.

This bill would allow qualified taxpayers to purchase 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. Additionally, it is unlikely that the homeownership savings account would qualify for preferential treatment for federal tax purposes.

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

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