STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

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Subject: Homeownership Savings Account/ 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.

Summary of Amendments

The April 17, 2018, amendments added a coauthor, eliminated the deduction for contributions to the homeownership savings account, modified the definition of "homeownership savings account," and modified and eliminated other definitions.

As a result of the amendments, a number of the department's implementation concerns, two of the technical concerns, and one of the policy concerns discussed in the department's analysis of the bill as introduced January 31, 2018, were resolved, and five additional implementation concerns and three technical concerns were identified. Except for the "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concerns" sections, the remainder of the department's analysis of the bill as introduced on January 31, 2018, still applies. The "Fiscal Impact" section has been restated below for convenience.

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.

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 earned during the taxable year on a homeownership savings account.

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 for the benefit of any person.
- Is established by a person, or by persons who are spouses, where the written governing instrument creating the account provides that: 1) all contributions to the account be in cash, including any refunds of taxes paid, and made by any person, including, but not limited to, contributions from relatives, employers, or crowdfunding Internet Web sites; and 2) the account is established to pay, pursuant to the requirements and limitations in this section, 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,[1] and regulations thereunder.
- Is the only homeownership savings account established by the person or spouses who established the account.
- The balance of the homeownership savings account does not exceed the maximum balance established for the account. The maximum balance would be 20 percent of the median home value within the state, as determined by the Department of Housing and Community Development (DHCD) and posted on its Internet Web site, for the year in which the account is created. The DHCD would be required to post the annual median home value on or before January 1 annually.
- Is closed once the purchase of the principal residence is completed.

This bill also would define the following terms and phrases:

- “Person” 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, and whose gross income for the taxable year in which the account was created and any taxable year in which a contribution is made does not exceed 120 percent of the area median income.
- “Qualified homeownership savings expenses” means a down payment or closing costs paid or incurred in connection with the purchase of a person’s principal residence within the meaning of Section 121 of the IRC, relating to exclusion of gain from sale of principal residence, in this state for use by the person who is the beneficiary of the homeownership savings account.
- “Trustee” would have the same meaning as that term under IRC section 408, relating to individual retirement accounts, and any regulations adopted thereunder.

[1] Section 408 of the IRC, 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 clear and unambiguous limit on the total amount that may be contributed.

The defined term "person" uses the phrase "gross income;" however, 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 adjusted gross income (AGI).

The phrase "area median income" is undefined. The absence of definitions to clarify this term could lead to disputes with taxpayers and would complicate the administration of this exclusion.

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.

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 is silent on the 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.

Technical Considerations

On page 2, lines 23-24, the phrase “person who is the beneficiary of the account” should be replaced with “person(s) who are beneficiary (ies) of the account” because the account can also be set up for spouses.

On page 3, line 9, it should be clarified that “January 1” of each year after January 1, 2018, the DHCD will post the median home value.

On page 3, line 11, the term “completed” should be replaced with the phrase “completed as evidenced by the close of escrow” to clarify when the homeownership savings account would be closed.

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 Amended April 17, 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	- $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 or for the net final payment method of accrual.

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 home buyers would open an individual 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 earnings of $7.7 million in 2020 and earnings 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.

Policy Concerns

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

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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