Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Patterson, et al.	Analyst:	Funmi Obatolu	Bill Number:	AB 198
Related Bills:	See Legislative History	Telephone:	845-5845	Introduced Date:	January 23, 2017
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: First-Time Home Buyer Expenses Deduction

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow a deduction for certain expenses paid or incurred by qualified first-time homebuyers for the purchase of a qualified principal residence.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

The reason for the bill is to encourage homeownership by providing a deduction for some of the costs paid or incurred in purchasing a principal residence.

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

Existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating adjusted gross income (AGI), such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self-employed individuals, retirement savings, and alimony. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as above-the-line deductions.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and only the portion that exceeds 2 percent of adjusted gross income may be deducted. Also, itemized deductions may be further limited for high-income taxpayers. These would be considered below-the-line deductions.

Current state and federal law lack a deduction similar to the one this bill would provide.

THIS BILL

For taxable years beginning on or after January 1, 2017, this bill would allow an above-the-line deduction for amounts paid or incurred by a qualified first-time home buyer during the taxable year for qualified principal home-buying expenses for the purchase of a qualified residence.

The bill would define the following terms:

- "Qualified first-time home buyer" means any individual, or the 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 qualified principal residence.
- "Qualified home-buying expenses" means the one-time costs paid or incurred by the qualified first-time home buyer relating to the purchase of a qualified residence during the taxable year, including, but not limited to, closing costs, notarization fees, and home inspection fees. "Qualified home-buying expenses" shall not include a down payment on the qualified principal residence. "Qualified home-buying expenses" may be paid or incurred during the preceding 12-month period ending on the date of the purchase of the qualified principal residence.
- "Qualified principal residence" means a single-family residence, whether detached or attached, that is purchased to be the principal residence of the taxpayer for a minimum of two years and is eligible for the homeowner's exemption under Revenue and Taxation Code section 218.

IMPLEMENTATION CONSIDERATIONS

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

The definition of "qualified home-buying expenses" lacks clarity and could result in disputes between taxpayers and the department. For example, "one-time costs" is undefined and could be argued to include expenses for repairs, renovations, the purchase of new appliances and soft goods (furniture and drapes), and moving expenses. Additionally, the bill fails to limit the look-back period to 12 months. For ease of administration and to clearly express the author's intent, this bill should be amended.

The bill lacks a limit on the total amount of qualified home-buying expenses that could be deducted. The author may wish to consider amending the bill to specify the maximum deductible amount.

It is unclear whether expenses paid or incurred during the 12 month period immediately preceding the qualified residence's purchase would be deductible on the return for the year the expense was paid or incurred or the year the qualified residence was purchased.

The deduction would be limited to expenses related to the purchase of a qualified residence. If the author intends to allow the deduction for expenses related to an otherwise qualifying purchase that fails to close, this bill should be amended.

The deduction would be allowed without regard to whether or for how long an otherwise qualified residence was occupied by the qualified first-time homebuyer or whether a homeowner's property tax exemption for the qualified residence was filed. If this is contrary to the author's intent, the bill should be amended.

TECHNICAL CONSIDERATIONS

For consistent use of defined terms throughout the bill, the term "qualified principal home-buying expenses" should be amended to read "qualified home-buying expenses" and the term "qualified residence" should read "qualified principal residence."

LEGISLATIVE HISTORY

Research of California legislation found no legislation similar to the provisions of this bill.

OTHER STATES' INFORMATION

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a deduction comparable to the deduction 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, costs will be identified and an appropriation will be requested, if necessary

ECONOMIC IMPACT

Revenue Estimate

Department staff is unable to determine a revenue estimate because the determination is dependent upon how the implementation concerns identified above are resolved.

SUPPORT/OPPOSITION

Support: None provided

Opposition: None provided

ARGUMENTS

Proponents: Some could argue that this bill would encourage home ownership in California by incentivizing first-time homebuyers with a deduction.

Opponents: Some could argue that the deduction this bill would create is insufficient relative to the cost to purchase a home.

POLICY CONCERNS

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

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 tax benefit by the Legislature.

LEGISLATIVE STAFF CONTACT

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