Franchise Tax Board **SUMMARY ANALYSIS OF AMENDED BILL**

Author:	Patterson, et al.	Analyst:	Funmi Obatolu	Bill Number:	AB 198
Related Bills:	See Prior Analysis	Telephone:	845-5845	Amended Date	April 17, 2017
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SUBJECT: First-Time Home Buyer Expenses Deduction

SUMMARY

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

RECOMMENDATION – NO POSITION

SUMMARY OF AMENDMENTS

The April 17, 2017, amendments added co-authors and a sunset date, modified several definitions, and made other technical changes. These amendments resolved several concerns discussed in the department's analysis of the bill as amended March 20, 2017. As a result of the amendments, the "This Bill," "Technical Considerations," "Implementation Considerations," "Economic Impact," and "Policy Concerns" sections have been revised. The "Fiscal Impact" section has been restated for convenience.

THIS BILL

For taxable years beginning on or after January 1, 2017 and before January 1, 2022, 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 home-buying expenses for the purchase of a qualified principal purchased during that taxable year.

The bill would define the following terms:

- "Qualified first-time home buyer" means any individual, or the individual's spouse, who has never had an ownership interest in a principal residence, and who is eligible for the homeowner's property tax exemption, with regard to the qualified principal residence, for the taxable year in which the deduction is claimed.
- "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 principal residence during the taxable year, including, closing costs, notarization fees, and home inspection fees. "Qualified home-buying expenses" would 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 meets all of the following requirements:
    - It is purchased to be the qualified principal residence of the taxpayer for a minimum of two years.
    - It is eligible for the homeowner’s exemption under section 218.
    - The purchase price does not exceed the amount established as the conforming loan limit, as determined by the United States Code,[1] for that type of residence.

The bill would be repealed by its own terms on December 1, 2022.

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 is not limited to closing costs, notarization fees, and home inspection fees, exclusively. The broad definition could result in disputes between taxpayers and the department. It is recommended to amend the bill to specify and limit the types of expenses that could be considered under the definition.

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 how 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.

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.

[1] Section 1454(a)(2) of Title 12 of the U.S. Code.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 198 As Amended April 17, 2017 Assumed Enactment After June 30, 2017 ($ in Millions)		
2017-18	2018-19	2019-20
- $220	- $140	- $140

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

Revenue Discussion

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 50 percent, or 260,000 housing units are sold to individuals who are first-time home buyers. Using Census migration data, it is estimated that 95 percent of home buyers would remain in their home for a minimum of two years.

First-time home buyers will pay an average of $22,000, or an estimated $5.5 billion, in closing costs and other expenses related to the purchase of a qualified principal residence. The estimated average tax rate for first-time home buyers is 2.5 percent, resulting in an estimated revenue loss for taxable year 2017 of $140 million.

The tax-year estimates are converted to fiscal years, and then rounded to arrive at the amounts reflected 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.

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

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