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

Author:	Steinorth, et al.	Analyst:	Funmi Obatolu	Bill Number:	AB 53
				Revised Date:	February 16, 2017
Related Bills:	See Prior Analysis	Telephone:	845-5845	Amended Date:	April 06, 2017
		Attorney:	Bruce Langston	Sponsor:	

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

SUMMARY OF AMENDMENTS

The April 6, 2017, amendments modified the definition of "qualified taxpayer" and made other technical changes. The amendments resolved all of the technical considerations and two of the implementation considerations discussed in the department's analysis of the bill as introduced on December 5, 2016,[1] and created an additional implementation consideration. As a result of the amendments, the "This Bill", "Implementation Concerns," and "Economic Impact" sections have been revised. The remainder of the department's analysis of the bill as introduced on December 5, 2016, still applies. The "Fiscal Impact" and "Policy Concerns" sections have been restated for convenience.

THIS BILL

For each taxable year beginning on or after January 1, 2017, this bill would allow qualified taxpayers to create a homeownership savings account. The income earned and the requirements and limitations on the homeownership savings account, except as provided in this bill, would receive the same treatment as a traditional IRA. 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.

[1] The bill, as introduced on December 5, 2017, was revised on February 16, 2017 to add co-authors.

A deduction would be allowed for contributions to a homeownership savings account as a miscellaneous itemized deduction subject to the 2 percent of Adjusted Gross Income (AGI) floor limitation, not to exceed the following amounts:

- Twenty thousand dollars ($20,000) for qualified taxpayers filing a joint, head of household, or surviving spouse (as defined in Section 17046) return.
- Ten thousand dollars ($10,000) in the case of a qualified taxpayer filing a return other than as described above.

Any amount withdrawn from a homeownership savings account would be included in the income of the qualified taxpayer for the taxable year in which the payment or distribution is made, unless the payment or distribution is used to pay for the qualified homeownership savings expenses of a qualified taxpayer who established the 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.
- Is established for the exclusive benefit of any qualified taxpayer establishing the account where the written governing instrument creating the account provides that: 1) all contributions to the account be in cash; and 2) the account is established to pay for the qualified homeownership savings expenses of a qualified taxpayer establishing 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.[2]
- Is the only homeownership savings account established by the qualified taxpayer.

This bill also would define the following terms and phrases:

- “Qualified homeownership savings expenses” means expenses, including a down payment or closing costs paid or incurred, in connection with the purchase of a qualified taxpayer’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 that qualified taxpayer who established the homeownership savings account.
- “Qualified taxpayer” means any individual, or individual’s spouse, who has never had an ownership interest in a principal residence within the meaning of IRC section 121, relating to exclusion of gain from 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 80 percent of the area median income.
- “Trustee” shall have the same meaning as that term under IRC section 408, relating to individual retirement accounts.

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[2] 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. The income accruing on these investments could be significant and if used for the specified purpose would be excluded from taxable income. 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 deductible amount of contributions to a homeownership savings account, unlike the rules governing excess contributions to IRAs, the bill lacks a clear and unambiguous limit on the total amount that may be contributed.

A principal residence could be interpreted to include property other than real property such as houseboat and house trailer. If this is contrary to the author's intent the bill should be amended.

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 definition of "qualified homeownership savings expenses" is overly broad. For example, it could be argued that 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. If this is contrary to the author's intent, the bill should be amended.

Because the bill fails to specify otherwise, if any amount of withdrawal from a homeownership savings account is used for non-qualified expenses, the entire amount withdrawn would be included in the income of the qualified taxpayer. If the author intends that only the amount used to pay for non-qualified expenses be included in income, this bill should be amended to clarify that a withdrawal is only taxable to the extent not used for qualified expenses. Additionally, if the author intends that non-qualified expenses be included in the qualified taxpayer's income regardless of whether the withdrawal was paid directly to the qualified taxpayer or paid to a third party on behalf of the qualified taxpayer, this bill should be amended.

Because the bill fails to specify otherwise, a homeownership savings account may remain open indefinitely, allowing the qualified taxpayer to continue making tax deductible contributions to and receiving tax deferred, and possibly excluded, earnings on investments made by the account's trustee.

The definition of "qualified taxpayer includes the undefined terms "area median income" and "gross income." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended. For example, the author may wish to consider replacing the reference to gross income with a reference to AGI, and specifying the years the AGI limitation would apply.

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 53 As Amended April 6, 2017 Assumed Enactment After June 30, 2017 ($ in Millions)		
2017-18	2018-19	2019-20
- $0	- $70	- $150

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. The analysis also assumes that once an account has been opened, taxpayers could continue contributing to the account after a home is purchased and use the money in the account to pay their mortgage.

Revenue Discussion

Although the bill is operative for taxable years beginning on or after January 1, 2017, financial institutions are not expected to be able to have the infrastructure ready until 2019. 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 buyers. Using Census migration data, it is estimated that 95 percent of homebuyers would remain in their home for a minimum of two years.

It is assumed that 80 percent of prospective home buyers would open a 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 250,000 accounts would be opened by the end of 2019 and taxpayers would contribute an average of $14,000. The deduction is subject to the 2-percent miscellaneous itemized deduction floor and it is assumed that 80 percent of taxpayers would qualify for the deduction.

It is estimated that qualified taxpayers would make $2.8 billion in qualified contributions to their homeownership savings account in 2019 and contributions plus interest would grow at an average of $1.2 billion annually. Applying the average tax rate of 4 percent, the estimated revenue loss would be $120 million in 2019 and $390 million in 2024. It is assumed that taxpayer would continue to maintain the homeownership savings account for their lifetime. As a result, the estimated revenue loss is expected to grow for the first 30 to 40 years the program is available. The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts 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 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 qualified taxpayers to purchase personal property with income excluded from tax.

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

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

LEGISLATIVE STAFF CONTACT

Funmi Obatolu
Legislative Analyst, FTB
(916) 845-5845
funmi.obatolu@ftb.ca.gov

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

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