

Author: Chen Analyst: Funmi Obatolu Bill Number: AB 731
Related Bills: See Legislative History Telephone: 845-5845 Introduced Date: February 15, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Homeowners' Association Assessments Deduction

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow an income tax deduction for amounts paid or incurred by a taxpayer for qualified homeowners' association assessments.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

The reason for this bill is to reduce the cost of homeownership in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and 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.

Neither federal nor state law allow a deduction similar to the one that would be provided by this bill.

THIS BILL

For taxable years beginning on or after January 1, 2017, this bill would allow as an "above-the-line"¹ deduction for an amount paid or incurred by the taxpayer during the taxable year, not to exceed \$5,000, for qualified homeowners' association assessments.

¹ A deduction that reduces gross income to arrive at AGI, before the itemized or standard deduction

The bill would define the following terms:

- “Homeowners’ association” has the same meaning as the term “association as” defined by Section 4080² of the Civil Code.
- “Qualified homeowners’ association assessments” means a regularly occurring, mandatory financial assessment that satisfies all of the following:
 - Is paid by the taxpayer to a homeowners’ association with respect to the taxpayer’s principal place of residence.
 - The revenues derived from the imposition of the assessment directly benefit the taxpayer’s principal place of residence.
 - The obligation to pay the assessment arises from the taxpayer’s mandatory and automatic membership in a homeowners’ association.

A qualified homeowners’ association assessment would specifically exclude special assessments.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations 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.

This bill uses terms that are undefined, i.e., “principal place of residence” and “special assessment”. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define the terms.

It is unclear how a taxpayer or the department would know whether revenues derived from the imposition of the assessment directly benefit the taxpayer’s principal place of residence. Would all regularly occurring, mandatory financial assessments paid during the taxable year qualify as direct benefit? Would expenses attributable to common areas (pool, club house, etc.) be limited to a percentage that approximates the taxpayer’s proportional interest in the common areas?

This bill would require payments made directly by the taxpayer with regard to their principal place of residence to a homeowners’ association that the taxpayer is mandatorily and automatically a member. Generally renters make payments directly to the owner and may not be mandatory, automatic members. Thus, the deduction would be limited to taxpayers that are owner-occupants. If this is contrary to the author’s intent, this bill should be amended.

² Civil Code section 4080 defines “association” as a nonprofit corporation or unincorporated association created for the purpose of managing a common interest development.

It is unclear how taxpayers and the department would verify the amount of the deduction. The author may wish to consider requiring that the homeowners' association provide an annual statement to each taxpayer of the amount of assessments paid during the year that qualify for the deduction.

TECHNICAL CONSIDERATIONS

The definition of "Homeowners' association" needs to be amended where the term "association as" appears, as it should be "association" to correspond to the definition in Section 4080 of the Civil Code.

For consistent use of terminology throughout the bill, the term "assessment" should be amended to read "regularly occurring, mandatory financial assessment."

LEGISLATIVE HISTORY

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

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax deduction.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 731 As Introduced February 15, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$360	- \$360	- \$360

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 data from the Foundation for Community Association Research and the real estate industry, it is estimated that California residents would pay an average of \$3,500 a year, or \$6.4 billion in qualified homeowners' association fees in 2017. It is estimated that 90 percent or \$5.8 billion of fees would be deductible for California taxpayers with positive AGI in 2017. Applying the assumed marginal tax rate of 6 percent results in an estimated revenue loss of \$360 million in 2017.

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that a deduction for qualified homeowners' association assessments would encourage homeownership by reducing the financial strain on California families residing in a property subject to these assessments.

Opponents: Some may argue that this bill would create inequitable tax treatment by recasting non-deductible homeowners' association expenses as deductible while failing to provide similar tax relief to property owners that are not governed by a homeowners' association.

POLICY CONCERNS

The bill lacks a requirement for the taxpayer or the principal residence to be in California.

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 deduction by the Legislature.

LEGISLATIVE STAFF CONTACT

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