

Author: Chen Analyst: Funmi Obatolu Bill Number: AB 731
Related Bills: See Prior Telephone: 845-5845 Amended Date March 27, 2017
Analysis Attorney: Bruce Langston Sponsor: _____

SUBJECT: Homeowners' Association Assessments Deduction

SUMMARY

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

RECOMMENDATION – NO POSITION

SUMMARY OF AMENDMENTS

The March 27, 2017, amendments added sunset and repeal language, and the defined term "qualified taxpayer," reduced the maximum allowable deduction, and made a technical correction. The March 27, 2017, amendments resolved one of the technical considerations and one of the implementation concerns discussed in the department's analysis of the bill as introduced on February 15, 2017, and additional implementation consideration and policy concern were identified. As a result of these amendments the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concern" sections have been revised. The remainder of the department's analysis of the bill as introduced February 15, 2017, still applies. The "Fiscal Impact" section has been restated for convenience.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning or after January 1, 2017, and before January 1, 2023.

THIS BILL

For taxable years beginning on or after January 1, 2017, and before January 1, 2023, this bill would allow as an "above-the-line"¹ deduction an amount paid or incurred by a qualified taxpayer during the taxable year, not to exceed \$3,000, for qualified homeowners' association assessments.

¹ A deduction that reduces gross income to arrive at Annual Gross Income (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.

For purposes of this deduction, “qualified taxpayer” would mean a taxpayer whose gross income for the taxable year does not exceed \$150,000.

This bill would be repealed by its own terms on December 1, 2023.

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?

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

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.

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.

Because the bill fails to specify otherwise, the maximum deduction would be available to each owner of a property that is otherwise eligible for the deduction with the exception of a married couple filing jointly. For example two unmarried individuals could each be eligible for a deduction of up to \$3,000, while a couple filing jointly would be limited to a \$3,000 deduction because the two individuals filing a joint return are considered one taxpayer. If the author intends that the maximum deduction of \$3,000 apply on a per property basis regardless of the number of owners that are qualified taxpayers, this bill should be amended.

TECHNICAL CONSIDERATIONS

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

FISCAL IMPACT

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

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 731 As Amended March 27, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$300	- \$300	- \$300

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, the real estate industry, and the Franchise Tax Board, it is estimated California resident taxpayers with gross income of \$150,000 or less would pay an average of \$3,500 a year in homeowners' association fees. Limiting the amount to \$3,000 per year, results in an estimated \$5.3 billion in

qualified homeowners' association fees in 2017. It is estimated that 90 percent or \$4.8 billion of fees would be deductible for California taxpayers with positive AGI Income in 2017. Applying the assumed marginal tax rate of 6 percent results in an estimated revenue loss of \$290 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.

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.

The gross income limitation of \$150,000 would apply to all taxpayers regardless of filing status which is inconsistent with longstanding tax policy that generally provides for differing limitations based on filing status.

LEGISLATIVE STAFF CONTACT

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