



## **Analysis of Amended Bill**

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Sponsor:

Bill Number: SB 1116

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Amended: April 2, 2018

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Related Bills: See Legislative  
History

**Subject:** Increased Exclusion on the Sale of a Principal Residence for First-Time Homeowners

### **Summary**

This bill would, under the Personal Income Tax Law (PITL), increase the maximum amount of the income exclusion on the sale of a principal residence, when the buyer is a first-time homeowner.

**Recommendation – No position.**

### **Summary of Amendments**

The April 2, 2018, amendments removed provisions of the bill related to the Health and Safety Code relating to the California Housing Finance Agency and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

### **Reason for the Bill**

The reason for the bill is to provide an incentive to owners of principal residences to sell their property to first-time homeowners that are subject to California income tax by increasing the maximum income tax gain exclusion.

### **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, 2018.

## **Federal/State Law**

Gross income means all income from whatever source derived, including gains from dealings in property, unless specifically excluded.<sup>1</sup>

Gain from the sale or exchange of property is excluded from gross income if, during the five-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more.<sup>2</sup>

### Limitation

The amount of gain excluded from gross income with respect to any sale or exchange of a principal residence is limited to \$250,000.<sup>3</sup>

In the case of a husband and wife who file a joint return for the tax year of the sale or exchange of the property, the \$250,000 limitation (described above) that applies to the exclusion of gain from the sale or exchange of a principal residence becomes \$500,000<sup>4</sup> if:

- Either spouse meets the ownership requirements with respect to the property;
- Both spouses meet the use requirements with respect to the property; and
- Neither spouse is ineligible for the benefits of the exclusion with respect to the property because of the one sale every two years rule.
- A surviving spouse may exclude from gross income up to \$500,000 of the gain from the sale or exchange of a principal residence owned jointly with a deceased spouse if the sale or exchange occurs within two years of the death of the spouse.<sup>5</sup>

### California Law

California imposes an income tax on the entire taxable income of residents of this state.<sup>6</sup> Nonresidents of California must include income from sources within this state, including gains realized from the sale or transfer of property located within this state.<sup>7</sup>

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<sup>1</sup> IRC section 61(a).

<sup>2</sup> IRC section 121(a).

<sup>3</sup> IRC section 121(b)(1).

<sup>4</sup> IRC section 121(b)(2).

<sup>5</sup> IRC section 121(b)(4).

<sup>6</sup> Revenue and Taxation Code (R&TC) section 17041.

<sup>7</sup> R&TC section 17951 and California Code of Regulations section 17951-3.

California conforms, under the PITL, to Internal Revenue Code (IRC) section 61,<sup>8</sup> relating to gains from dealings in property, and to IRC section 121,<sup>9</sup> relating to exclusion of gain from the sale of principal residence, as of the “specified date” of January 1, 2015,<sup>10</sup> with modifications unrelated to the provisions of this bill.

### **This Bill**

This bill would increase the maximum gain on the sale of a principal residence that may be excluded from income from \$250,000 to \$300,000 for individuals, and from \$500,000 to \$600,000 for joint return filers and surviving spouses, when the buyer is a first-time homeowner who is subject to income taxation imposed by the PITL.

### **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.

This bill uses the undefined term “first-time homeowner.” The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, this bill should be amended.

It is unclear how the department and a seller would verify that at the time of the sale the purchaser was a “first-time homeowner” and subject to California income tax.

Because the bill fails to specify otherwise, the increased exclusion would be triggered on a sale to an otherwise eligible purchaser regardless of:

- Whether or for how long the purchaser occupied the property as their principal residence.
- Whether the seller and the purchaser are related parties.

If this is contrary to the author’s intent this bill should be amended.

### **Technical Considerations**

Subdivision (g) needs to be amended where the phrase "by this state" appears, to "under this Part" for consistency and internal harmony within the PITL.

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<sup>8</sup> R&TC section 17071.

<sup>9</sup> R&TC section 17152.

<sup>10</sup> R&TC section 17024.5.

## Legislative History

SB 401 (Wolk, Chapter 14, Statutes of 2010) changed the specified date from January 1, 2005, to January 1, 2009, for taxable years beginning on or after January 1, 2010, which among other things, conformed to federal law that allows surviving spouse to exclude from gross income up to \$500,000 of the gain from sale of principal residence if the sale occurs within 2 years of the death of the spouse.

AB 1806 (Hagman, 2009/2010), would have provided conformity to the federal capital gain exclusion from gross income on the sale of a personal residence by a surviving spouse. AB 1806 failed to pass out of the Assembly Revenue and Taxation Committee.

SB 1416 (Walters, 2009/2010) would have provided an exclusion from gross income, without limitation, for gain on the sale or exchange of a principal residence by a taxpayer 65 years or older. AB 1806 failed to pass out of the Senate Revenue and Taxation Committee.

## Other States' Information

Review of *Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable increase in gain exclusion for selling a principal residence to a first-time homeowner. These states were selected and reviewed due to their similarities to California's economy and tax laws.

## Fiscal Impact

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill moves through the legislative process and implementation concerns are resolved, costs will be identified.

## Economic Impact

### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1116 as Amended April 2, 2018  
For Taxable Years Beginning On or After January 1, 2018  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$130
2019-2020	- \$75
2020-2021	- \$75

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

## Revenue Discussion

This revenue estimate is based on a proration of the Joint Committee on Taxation (JCT) federal tax expenditure estimate for the exclusion of capital gains on sales of principal residences. In January 2017, the JCT estimated the federal revenue impact of the exclusion to be \$33 billion in federal fiscal year 2019. To determine California's share of the federal loss, California Association of Realtors (CAR) and National Association of Realtors data was used to calculate that 19 percent of dollar volumes for homes sales are attributable to California, then federal and state capital gains tax rates were analyzed to estimate a federal/state tax adjustment of 60 percent,<sup>11</sup> or \$3.8 billion. Using data from the CAR, it was determined that 35 percent of home sales are to first-time homeowners. Of the sales to first-time homeowners, it is estimated that there would be a five percent increase in the amount excluded, resulting in an estimated revenue loss of \$65 million in taxable year 2018.

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: Orange County Realtors Association.

Opposition: None provided.

## Arguments

Proponents: Some may argue that increasing the excludable gain on the sale of a principal residence to a first-time homeowner would increase homeownership in California.

Opponents: Some may argue that because of the tax incentive for a seller of a principal residence, first-time homeowners would receive an unfair economic advantage over other potential buyers of real property since sellers would be incentivized to sell to these first-time homeowner buyers due to the increased exclusion amounts.

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<sup>11</sup> Adjustment based on tax rate prior to the enactment of the Tax Cuts and Jobs Act of 2017 (P.L. 115-97)

## Policy Concerns

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 a tax benefit by the Legislature.

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