STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Brough	Sponsor:	Bill Number: AB 2115
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

SUBJECT

Homeownership Savings Account Gross Income Exclusion

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), create an exclusion from gross income for income earned on contributions to a "homeownership savings account" (HomeSA).

This analysis only addresses the provisions that would impact the department.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to encourage and promote individual homeownership in the Counties of Los Angeles, Orange, and San Diego.

ANALYSIS

For taxable years beginning on or after January 1, 2021, and before January 1, 2026, this bill would, under the PITL, exclude from gross income any income earned during the taxable year on moneys contributed to the HomeSA.

The bill would define a HomeSA as a trust that meets all of the following requirements:

- Is designated as a HomeSA by the trustee for the benefit of any qualified taxpayer (QTP).

- Is established by a QTP where the written governing instrument creating the HomeSA provides that:
  1) All contributions to the account be in cash, including refunds of taxes paid, and can be made by any person; including, but not limited to, contributions from relatives, employers, or crowd-funding internet websites.
  2) The account is established to pay for the qualified homeownership savings expenses (HomeSE) of the QTP who is the beneficiary of 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.
- Is the only HomeSA established by the QTP who established the account.
- The balance of the HomeSA does not exceed the maximum balance established for the account. "Maximum balance" of the HomeSA would mean 20 percent of the median home price within the county in which the QTP resides in September of the prior year, as determined by the Department of Housing and Community Development (DHCD) as posted on its internet website. This bill would require the DHCD to post the annual median home price on or before January 1, 2021, and each January 1st thereafter.
- Is established by a QTP whose gross income does not exceed 80 percent of the area median income of a city and county for the taxable year in which the account is established. A QTP shall contribute to the HomeSA only in the taxable years in which the QTP's gross income does not exceed 80 percent of the area median income of a city and county.
- Is closed once the purchase of a principal residence is complete.

This bill also would define the following terms and phrases:

- "Qualified homeownership savings expenses" means the down-payment and closing costs paid or incurred, in connection with the purchase of a QTP's principal residence within the meaning of IRC section 121, relating to exclusion of gain from the sale of principal residence, in the Counties of Los Angeles, Orange, or San Diego for use by the QTP, who is the beneficiary of the HomeSA.
- "Qualified taxpayer" means an individual, individual's spouse, or individuals who are spouses filing jointly, who have never had an ownership interest in a principal residence within the meaning of IRC section 121, relating to exclusion of gain from the sale of principal residence, and includes only an individual, individual's spouse, or individuals who are spouses filing jointly, who reside in the Counties of Los Angeles, Orange, or San Diego, and have filed taxes while residing in that county for at least one year.
- "Trustee" shall have the same meaning as that term under IRC section 408, relating to IRAs.

This bill would require, on or before December 1, 2026, the Legislative Analyst (LA) to report to the Legislature on the effectiveness of the exclusion. The report shall include, but is not limited to, an analysis of the number of first-time homebuyers taking advantage of the exclusion and the impact of the exclusion on the homeownership rates in California.

For purposes of the report, the LA may request, and notwithstanding Revenue and Taxation Code (R&TC) section 19542, the Franchise Tax Board (FTB) shall provide any data requested by the LA.

If enacted, this section would remain in effect only until December 1, 2026, and as of that date would be repealed.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2021, and before January 1, 2026.

Federal/State Law

Individual Retirement Accounts (IRAs)

Federal law provides for two types of IRAs: traditional IRAs and Roth IRAs. In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Contributions to IRAs are limited for 2020 to the lesser of $6,000 ($7,000 if age 50 or older), or the taxpayer's taxable compensation for the year.

A taxpayer that receives a distribution from a traditional IRA prior to age 59 1/2, death, or disability, is generally subject to a 10-percent additional tax on the amount includable in income for federal purposes, unless an exception to that additional tax applies. Among other exceptions, the 10-percent additional tax does not apply to a one-time distribution of up to $10,000 made to first-time homebuyers for the qualified acquisition cost of a residence.

California law automatically conforms to the federal rules regarding qualifications that apply to IRAs, except that the additional tax on nonqualified distributions is modified to be 2.5 percent for California purposes instead of the federal 10 percent rate.

Neither federal nor state law allows an exclusion similar to the one this bill would allow.

Implementation Considerations

The department has identified the following implementation considerations for purposes of a high-level discussion. Additional considerations 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 issues that may be identified.

To establish and offer HomeSAs, financial institutions would need to follow existing federal guidelines, which research has indicated may take time to satisfy. Should this bill be enacted, financial institutions may not be able to offer HomeSAs until 2023 or 2024. The author may wish to extend the sunset date.

The definition of HomeSAs 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. Additionally, the early distribution penalty and contribution limits applicable to IRAs would apply to HomeSAs. For consistency with the author's intent and to avoid conflicting requirements, this bill should be amended to specify which of the IRC's IRA provisions should be applicable to HomeSAs.

Principal residence, within the meaning of IRC section 121, includes property other than a home or condominium, such as a houseboat or 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, the individual's spouse, or individuals who are spouses filing jointly, each spouse would be eligible to establish separate HomeSA. If this is contrary to the author's intent, this bill should be amended.

The balance of the HomeSA cannot exceed the "maximum balance" established for the account. The maximum balance of a HomeSA is 20 percent of the median home price within the county that the QTP resides in as of "September of the prior year," as determined by the DHCD. For clarity and ease of administration, the author should consider amending the date to be more specific, e.g., September 1 of the prior year or September 30 of the prior year.

This bill would allow a QTP whose "gross income" does not exceed 80 percent of the area median income of a city and county for the "current taxable year" to contribute to a HomeSA during the year if their income for the "current year" is below the threshold. Gross income and median income amounts are generally not known until after the end of the year. For certainty of the current year HomeSA contribution amounts, the author may wish to amend the bill to base the threshold on the "prior year" gross income and prior year's area median income of a city and county. In addition, no limitation on other persons who are not the QTP (i.e., relatives, crowd-funders, employers, etc.,) from contributing to the account if the QTP's income exceeds the threshold. The limit only precludes the QTP from contributing. If this is contrary to the author's intent, the bill should be amended.

Note, the reference is made to "a" city and county. If the author's intent is a comparison to a city and county where the taxpayer resides or a city and county in the Counties of Los Angeles, Orange, and San Diego, it is recommended that the bill be amended to reflect the author's intent.

The bill is silent on the treatment of a HomeSA if the balance exceeds the maximum balance established for the account, or other criteria are not satisfied. For clarity and ease of administration, the bill should be amended to specifically state the author's intent. For example, does the excess balance qualify for the income exclusion? Income earned on moneys contributed for taxable years beginning on or after January 1, 2021, and before January 1, 2026, qualify for the income exclusion, however, there are no specific requirements for when a home must be purchased. What happens if previously excluded HomeSA income is used to pay for expenses other than qualified HomeSE?

The bill uses undefined terms, i.e., "income earned," "relatives," "down-payment," "closing costs," and "filed taxes." 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 to provide these definitions.

The provisions of this bill allow for the exclusion of earned income on the moneys deposited in HomeSAs, and require that the HomeSA be closed once the home purchase is complete. The FTB would be unaware of when the purchase was completed. Thus, the FTB could not enforce this requirement absent an audit. If the author would like the FTB to be able to verify this information, a requirement to provide this information to the FTB should be added.

If requested, this bill could require the FTB to provide confidential taxpayer information to the LA. However, the bill fails to allow the disclosure of such information or prohibit the LA from further disclosure of confidential taxpayer information. An exception from the general disclosure provisions should be added to specifically allow the FTB to comply with the bill's provision on disclosure of tax information and apply the appropriate disclosure restrictions to the LA.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 1317 (Brough, 2019/2020), similar to this bill, would have created a HomeSA that would have included income tax benefits similar to an IRA. AB 53 failed to pass by the constitutional deadline.

AB 53 (Steinorth, et al., 2017/2018), similar to this bill, would have created an individual HomeSA that would have included income tax benefits similar to an IRA. AB 53 failed to pass by the constitutional deadline.

AB 1758 (Steinorth, 2017/2018), similar to this bill would have created a HomeSA that would have provided certain income tax benefits similar to an IRA. AB 1758 failed to pass the Assembly Housing and Community Development Committee.

AB 1979 (Bonta & Steinorth, 2017/2018), similar to this bill would have created a HomeSA that would have provided certain income tax benefits similar to an IRA. AB 1979 failed to pass the Assembly Appropriations Committee.

AB 1736 (Steinorth, et al., 2015/2016), similar to this bill, would have created a HomeSA that would have included income tax benefits similar to an IRA. AB 1736 failed to pass by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

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.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

This bill, as introduced on February 6, 2020, has an estimated revenue loss of $1,000 for every $1 million of qualified contributions. However, due to the timing of the sunset date and regulatory requirement to setup such an account, it is not clear how many banks would participate and how many taxpayers would open accounts. As a result, the revenue loss is unknown.

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

The revenue impact of this bill would depend on the number of financial institutions that go to the effort to offer this type of savings account, and how many taxpayers would open up these accounts for the two or three years it would be available. Research indicates the process of offering a new type of savings account would take several years to establish; therefore, it is assumed HomeSAs would not be available until 2023 or 2024 at the earliest.

Due to the timing of the infrastructure, the uncertainties around financial institutions offering this type of account, and taxpayer's interest in these accounts for the short duration available, it is assumed that for every $1 million in qualified contributions, approximately $50,000 in interest or dividends would be earned. Applying an average tax rate of 2 percent, the estimated revenue loss would be $1,000.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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