STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

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Subject: Gain Exclusion from Sale of Principal Residence to First-Time Homebuyer

Summary

This bill would, under the Personal Income Tax Law (PITL), increase the maximum gain a taxpayer may exclude on the sale of a principal residence to a first-time home buyer.

This bill would also modify provisions of the California Environmental Quality Act under the Public Resource Code (PRC).

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

Recommendation – No position.

Summary of Amendments

The March 25, 2019, amendments removed provisions of the bill that would have modified the Government and Health and Safety Codes, related to housing, modified provisions of the PRC, and added provisions modifying the PITL as 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 offer incentives to sellers who sell to first-time home buyers in order to promote market mobility for all Californians.

Effective/Operative Date

This bill would be effective January 1, 2020, and operative for taxable years beginning on or after January 1, 2020.

Federal/State Law

Gross income means all income from whatever source derived, including gains from dealings in property, unless specifically excluded.[1]

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.[2]

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.[3]

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[4] 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.[5]

California Law

California imposes an income tax on the entire taxable income of residents of this state.[6] 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.[7]

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[1] IRC section 61(a).
[2] IRC section 121(a).
[3] IRC section 121(b)(1).
[4] IRC section 121(b)(2).
[5] IRC section 121(b)(4).
[6] Revenue and Taxation Code (R&TC) section 17041.
[7] R&TC section 17951 and California Code of Regulations section 17951-3.

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

This Bill

This bill would, under the PITL, increase the amount of 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 subject to 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 definitions to clarify this term 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 the department and a seller would verify that at the time of the sale the buyer 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), on page 25 at lines 15-16, needs to be amended to replace "by this state" with "under this Part" for consistency and internal harmony within the PITL.

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[8] R&TC section 17071.
[9] R&TC section 17152.
[10] R&TC section 17024.5.

Legislative History

SB 1116 (Moorlach, 2017/2018), would have increased the maximum amount of the income exclusion on the sale of a qualified principal residence to a certified qualified first-time homeowner. SB 1116 failed to pass out of the Senate by the constitutional deadline.

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 allowing a 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 their spouse's death.

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 by the constitutional deadline.

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 by the constitutional deadline.

Other States' Information

The states surveyed include *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.

These states allow an exclusion of $250,000 of gain ($500,000 for certain joint filers) from the sale of a principal residence in conformity or reference to federal law. However, these states do not allow an increase in gain exclusion for selling a principal residence to a first-time homeowner that this bill would allow.

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:

Estimated Revenue Impact of SB 384 as Amended March 25, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	Revenue
2019-2020	-$120
2020-2021	-$80
2021-2022	-$85

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 federal Joint Committee on Taxation (JCT) tax expenditure estimate for the exclusion of capital gains on sales of principal residences. In October 2018, the JCT estimated the federal revenue impact of the exclusion to be $36 billion in federal fiscal year 2019.

California Association of Realtors and National Association of Realtors data was used to determine California's share of the federal loss. It was determined that 19 percent of homes sales are attributable to California. Federal and state capital gains tax rates were analyzed to estimate a federal/state tax adjustment of 60 percent, or $4.1 billion. Using data from the California Association of Realtors, it was determined that 35 percent of home sales are to first-time home buyers. Of these sales, it is estimated that there would be a five percent increase in the amount excluded, resulting in an estimated revenue loss of $70 million in taxable year 2019.

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

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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