STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Lee

Sponsor:

Related Bills: See Legislative History

Bill Number: AB 946

Introduced: February 17, 2021

SUBJECT

Disallow Second Home Mortgage Interest Deduction

SUMMARY

Under the Personal Income Tax Law, this bill would reduce the home mortgage interest paid deduction and require the Franchise Tax Board (FTB) to annually estimate and report to the State Controller's Office (SCO), the expected or anticipated additional amounts of tax revenue. SCO would then be required to transfer such amounts from the General Fund to the Home Purchase Assistance Fund.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to provide additional funds to homebuyer assistance programs like the California Housing Finance Agency's My Home Assistance Program.

ANALYSIS

For taxable years beginning on or after January 1, 2022, this bill would disallow the mortgage interest deduction on indebtedness with respect to a qualified residence other than a principal residence.

This bill would require the FTB in consultation with the Department of Finance (DOF), to estimate the amount of additional revenue, for taxable years beginning on or after January 1, 2021, and before January 1, 2022, that would have resulted from the modifications to the mortgage interest deduction if the bill's provisions were operative during such taxable years, and report such estimates to SCO no later than June 1, 2022.

This bill would also, no later than June 1, 2023, and annually thereafter, require the FTB in consultation with the DOF, to estimate the amount of additional revenue resulting from the modifications to the mortgage interest deduction and report such estimates to SCO. The estimate would be for the taxable years beginning on or after January 1 of the calendar year immediately preceding the year in which the estimate is made and before January 1 of the calendar year in which the estimate is made and require that the SCO be notified of that amount.

The SCO shall transfer estimated amounts, reported from the FTB, from the General Fund to the Home Purchase Assistance Fund, upon receiving notifications.

Effective/Operative Date

This bill would become effective January 1, 2022, and specifically operative for taxable years beginning on or after January 1, 2022.

Federal/State Law

Federal Law

As a general matter, personal interest is not deductible. Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition Indebtedness

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which is secured by the residence. For taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017, this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately). For taxable years beginning after December 31, 2025, a taxpayer may treat up to $1,000,000 ($500,000 in the case of married taxpayers filing separately) of indebtedness as acquisition indebtedness, regardless of when the indebtedness was incurred.

Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness, but only to the extent of the amount (and term) of the refinanced indebtedness.

Interest on acquisition indebtedness is allowable in computing alternative minimum taxable income. However, in the case of a second residence, the acquisition indebtedness may only be incurred with respect to a house, apartment, condominium, or a mobile home that is not used on a transient basis.

Home Equity Indebtedness

Home equity indebtedness is any indebtedness protected by a qualified residence to the extent the combined amount of indebtedness does not exceed the fair market value of the qualified residence, reduced by the amount of acquisition indebtedness. The aggregate amount of home equity indebtedness may not exceed $100,000 (or $50,000 on a separate return by a married individual) for any period. For any indebtedness incurred before October 13, 1987, indebtedness shall be treated as acquisition indebtedness, and no limit shall apply.

State Law

Under state law, for acquisition indebtedness incurred on or after October 13, 1987, the aggregate amount of acquisition indebtedness may not exceed $1,000,000 (or $500,000 in the case of married persons filing separately).

California conforms to the federal law that defines a qualified residence as the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence, as of January 1, 2015.

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.

The bill requires the FTB to notify SCO by June 1, 2023, and annually thereafter of an estimate of additional revenue that results from the bill's provisions, but lacks a specification of the taxable years to be annually estimated. For clarity and ease of administration, it is recommended that the bill be amended.

The department lacks the ability to determine mortgage interest deduction amounts that would be disallowed from a second home, and would need to develop a new form or worksheet, with related processing and system updates, to determine the estimated annual amounts of additional revenue that are required by the bill.

Technical Considerations

None noted.

Policy Considerations

The provision in this bill that disallows a deduction for interest on second homes would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

Because this bill would eliminate a California deduction for taxpayers that have already made the decision to incur mortgage obligations for property purchased before this bill is effective, taxpayers could face unexpected increased California tax liability due to the elimination of the deduction for interest on indebtedness with respect to a qualified residence other than a principal residence.

LEGISLATIVE HISTORY

AB 1905 (Chiu & Wicks, 2019/2020), similar to this bill, would have under the PITL, reduced the home mortgage interest paid deduction and required the FTB to annually estimate and report to the SCO, the expected or anticipated additional amounts of tax revenue. SCO would then be required to transfer such amounts from the General Fund to a new state fund created to address homelessness in California. AB 1905 did not pass out of the Assembly by the constitutional deadline.

AB 71 (Chiu, 2017/2018) would have disallowed the deduction of mortgage interest paid on a second home and modify the existing Low-Income Housing Credit (LIHC). AB 71 did not pass out of the Assembly by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department would need to create a new tax form or worksheet to obtain the data necessary to calculate and report the estimated annual amount of reduction in mortgage interest deductions. As a result, this bill would impact the department's programming, printing, and processing costs. As the bill continues to move through the legislative process, costs will be identified, and a budget change proposal will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

The following Revenue Estimate is revised.

This bill would result in the following revenue gain:

Revised Estimated Revenue Impact of AB 946 as Introduced February 17, 2021
Assumed Enactment after June 30, 2021

($ in Millions)

Fiscal Year	Revenue
2021-2022	$70
2022-2023	$120
2023-2024	$130

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.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov