STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Patterson, et al.	Sponsor:	Bill Number: AB 1865
	Related Bills: See Legislative History	Introduced January 18, 2024, Amended February 15, 2024

SUBJECT

Homeownership Savings Account Exclusion and Deduction

SUMMARY

This bill, under the Personal Income Tax Law, would create a homeownership savings account (HomeSA) that would provide certain income tax benefits similar to an individual retirement account (IRA) for taxable years beginning on or after January 1, 2024, and before January 1, 2029.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The February 15, 2024, amendments added coauthors and a sunset date to the bill.

REASON FOR THE BILL

The reason for the bill is to encourage homeownership.

ANALYSIS

For each taxable year beginning on or after January 1, 2024, and before January 1, 2029, gross income would not include any income accruing during the taxable year to the HomeSA under the same conditions as provided by the Internal Revenue Code (IRC) section 408, relating to IRAs. For each taxable year beginning on or after January 1, 2024, the qualified taxpayer's annual contribution to the HomeSA would be deductible.

A deduction would be allowed for contributions to the HomeSA equal to the amount contributed by a qualified taxpayer during the taxable year, not to exceed the following amounts:

- $20,000 for qualified taxpayers filing a return based on a joint, head of household, or surviving spouse filing status.
- $10,000 for qualified taxpayers filing a return based on any other filing status.

Any amount withdrawn from the HomeSA would be included in the qualified taxpayer's income for the taxable year in which the payment or distribution is made unless the payment or distribution is used to pay for the qualified taxpayer's "qualified homeownership savings expenses."

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

- Designated as a HomeSA by the trustee.
- Established by a qualified taxpayer, or by qualified taxpayers who are spouses, for the exclusive benefit of any qualified taxpayer establishing the account where the written governing instrument creating the account provides that:
  - All contributions to the account are required to be in cash.
  - The account is established to pay, pursuant to the requirements and limitations of this section, for the qualified homeownership savings expenses of a qualified taxpayer that established the account.
- Except as otherwise required or authorized by this bill, is subject to the same requirements and limitations as an IRA established under IRC section 408, relating to IRAs, and any regulations adopted thereunder.
- The only HomeSA established by the qualified taxpayer.

In addition, the bill defines the following terms:

- "Qualified taxpayer" would mean any individual, or individual's spouse, who had no present ownership interest in a principal residence within the meaning IRC section 121, relating to exclusion of gain from sale of principal residence, during the preceding three-year period ending either on the date of the individual's, or individual's spouse's, contribution to a HomeSA or on the date of the individual's, or individual's spouse's, purchase of the principal residence for which any amount that is withdrawn from the individual's, or individual's spouse's, HomeSA.
- "Qualified homeownership savings expenses" would mean expenses, including a downpayment or closing costs, paid or incurred in connection with the purchase of a qualified taxpayer's principal residence within the meaning of IRC section 121, relating to exclusion of gain from sale of principal residence, in this state for use by the qualified taxpayer who established the HomeSA.

- "Trustee" would have the same meaning as that term has under IRC section 408, relating to IRAs, and any regulations adopted thereunder.

The specific goal, purpose, and objective of the bill exclusion and deduction is to assist those seeking to save money to buy a home. For both the exclusion and the deduction, this bill would require, for purposes of complying with Revenue and Taxation Code (RTC) section 41, by May 1, 2026, and annually thereafter, the Franchise Tax Board (FTB) must provide a written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, and the Senate and Assembly Revenue and Taxation Committees, which provides the following information, to the extent it is available, the:

- Number of taxpayers allowed a deduction pursuant to this section.
- Average amount of the deduction allowed.

The disclosure provisions of this bill would be treated as an exception to the FTB's general prohibition against disclosure of confidential taxpayer information.

The HomeSA exclusion and deduction would remain in effect until December 1, 2029, 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, 2024, and before January 1, 2029.

Federal/State Law

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 2023 to the lesser of $6,500 ($7,500 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% additional tax on the amount includable in income for federal purposes, unless an exception to that additional tax applies. Among other exceptions, the 10% 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% for California purposes instead of the federal 10% rate.

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

RTC Section 41 Requirements

Legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit. There is no comparable provision in federal law.

Implementation Considerations

The FTB 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. FTB staff is available to work with the author's office to resolve these and other considerations that may be identified.

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, the author may wish to amend the bill to specify which of the IRA provisions should be applicable to HomeSAs.

The bill does not specify a limit on the total amount that may be contributed to a HomeSA in any given year, or if contributions to the HomeSA exceed the annual deduction limits, whether the income earned on the excess would also qualify for the income exclusion.

The bill defines the term "trustee" by reference to IRC section 408. However, IRC 408 does not contain a definition of trustee. The author may wish to define the term to provide clarity.

The bill does not specify a requirement to reside in the home as a principal residence for a specific period. After the home purchase, the property could be transitioned to investment property. If this is contrary to the author's intent, the author may wish to amend the bill.

Technical Considerations

For consistency of terminology, in Section 17141.79. (a), consider replacing, "…accounts, any income accruing during…" with "…accounts, any income earned during…" as most individual taxpayers use the cash-basis method rather than the accrual method of tax accounting.

For clarity when defining qualified expenses for the home purchase, consider removing the reference to Section 121, relating to the exclusion of gain from sale of principal residence, i.e., replace "'Qualified homeownership savings expenses' means expenses,… a qualified taxpayer's principal residence within the meaning of Section 121 of the Internal Revenue Code, relating to exclusion of gain from sale of principal residence, in this state for…" with "'Qualified homeownership savings expenses' means expenses,… a qualified taxpayer's principal residence in this state for…"

Policy Considerations

The bill would allow contributions made to HomeSAs to be treated as a miscellaneous itemized deduction. To claim the deduction, taxpayers would need to itemize their deductions rather than claim the standard deduction, and in addition to the $20,000 or $10,000 limitation dependent on filing status, the deduction would also be limited to the portion that exceeds 2% of their AGI. If this is contrary to the author's intent, the author may wish to amend the bill.

This bill would create differences between federal and California tax law; thereby increasing the complexity of California tax return preparation. This bill would establish a deduction and an ongoing exclusion for which federal law has no counterpart; thus, increasing nonconformity and the complexity of California tax return preparation. If this is contrary to the author's intent, the author may wish to amend the bill.

LEGISLATIVE HISTORY

AB 1317 (Brough, 2019/2020), AB 2115 (Brough, 2019/2020), AB 1758 (Steinorth, 2017/2018), and AB 1979 (Bonta & Steinorth, 2017/2018), similar to this bill, would have created a HomeSA that would have included income tax benefits similar to an IRA, including the exclusion of income earned on the HomeSA. AB 1317 and AB 1979 did not pass out of the Assembly Appropriations Committee by the constitutional deadline. AB 2115 and AB 1758 were held without further action by the Assembly Housing and Community Development Committee.

AB 53 (Steinorth, et al., 2017/2018), similar to this bill, would have created a HomeSA that would have included income tax benefits similar to an IRA, including the exclusion of income earned on the HomeSA and a deduction for certain contributions made to the HomeSA. AB 53 did not pass out of the Assembly Appropriations Committee by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

The bill, as amended on February 15, 2024, would not impact state income or franchise tax revenue.

In order for a financial institution to set up a new type of savings account, they must meet existing federal guidelines. Research indicates the process of offering a new type of saving account would take up to three years to establish; therefore, it is assumed that the earliest HomeSAs would be available beginning in calendar year 2026. Due to the sunset date of December 31, 2028, it is assumed that no financial institution would complete the necessary steps to offer a savings account that would only be available for two or three years.

However, should the infrastructure be in place for qualified taxpayers to take advantage of the HomeSA, it is anticipated that for every $5 million of qualified contributions made and applying an average tax rate of 7%, the estimated revenue loss would be approximately $350,000.

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

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