



## **Bill Analysis**

Author: Jim Patterson, et al.

Sponsor:

Bill Number: AB 1865

Related Bills: See Legislative  
History

Amended: April 18, 2023

### **SUBJECT**

Homeownership Savings Account Exclusion

### **SUMMARY**

This bill, under the Personal Income Tax Law, would exclude from income amounts accrued to a homeownership savings account (HomeSA) for taxable years beginning on or after January 1, 2025, and before January 1, 2030.

### **RECOMMENDATION**

No position—The Franchise Tax Board (FTB) has not formally voted or taken a position on this bill.

### **SUMMARY OF AMENDMENTS**

The April 18, 2024, amendments removed the allowance of the deduction for payments made to a HomeSA and the application of the individual retirement account (IRA) provisions for the gross income exclusion; revised the definitions of a HomeSA and a qualified taxpayer; modified the operative date; and updated the repeal date and the Revenue and Taxation Code (RTC) section 41 requirements.

The amendments resolved two of the Implementation Considerations, one Technical Consideration, and one of the Policy Considerations discussed in the FTB analysis of AB 1865 as introduced January 18 and as amended February 15, 2024. The amendments created a new Implementation Consideration and new Policy Considerations.

### **REASON FOR THE BILL**

The reason for the bill is to encourage homeownership.

### **ANALYSIS**

For each taxable year beginning on or after January 1, 2025, and before January 1, 2030, gross income would not include any amount accruing to a first-time HomeSA whose beneficiary is a qualified taxpayer.

Any amount withdrawn from a first-time HomeSA would be included in the qualified taxpayer's income for the taxable year in which the payment or distribution is made unless the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" of the qualified taxpayer who established the HomeSA.

The bill would define a "First-Time HomeSA" as an account with a financial institution that is:

- Designated as a first-time HomeSA by the account holder.
- Established by a qualified taxpayer, or by qualified taxpayers who are spouses, for the exclusive benefit of a 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 for the qualified homeownership savings expenses of a qualified taxpayer that established the account.
- The only first-time HomeSA established by the qualified taxpayer.

In addition, the bill defines the following terms:

- "Principal residence" would have the same meaning as that term is used in Internal Revenue Code (IRC) section 121.
- "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.
- "Qualified taxpayer" would mean any individual, or individual's spouse, who had no present ownership interest in a 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 first-time 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 first-time HomeSA.

The bill states that the specific goal, purpose, and objective of the exclusion is to assist those seeking to save money to buy a home. This bill would require, for purposes of complying with RTC section 41, by May 1, 2027, and annually thereafter, the FTB to 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 excluding income pursuant to this section.
- Average amount of the excluded income.

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 would remain in effect until December 1, 2030, 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, 2025, and before January 1, 2030.

#### *Federal/State Law*

##### *In General*

Federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Types of income currently excluded include amounts received as a gift or inheritance, certain compensation for injuries and sickness, educational assistance programs, foster care payments, interest received on certain state or federal obligations, and qualified scholarships. Generally, for contributions to a bank savings account that are not tax deductible, while the interest earned annually on the account is included in taxable income, the amounts withdrawn from the account are excludable from gross income.

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 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 bill is silent as to how distributions from HomeSA accounts used for qualified expenses would be treated after the January 1, 2030, repeal date.

In addition, the bill requires contributions to be paid in cash. The author may want to replace “cash” with “cash and cash equivalents” to mean other cash forms, such as checks.

#### *Technical Considerations*

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 by replacing, ““Qualified homeownership savings expenses’ means 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 Section 121 of the IRC, relating to exclusion of gain from sale of principal residence, in this state for use by that qualified taxpayer who established the first-time homeownership savings account.” with ““Qualified homeownership savings expenses’ means expenses, including a downpayment or closing costs, paid or incurred in connection with the purchase of a qualified taxpayer’s principal residence in this state for use by that qualified taxpayer who established the first-time homeownership savings account.”

#### *Policy Considerations*

The bill does not specify a limit on the total amount that may be contributed to a HomeSA in any given year.

The bill uses the term principal residence under Section 121. As such, the HomeSA could apply to a condominium, apartment, trailer, etc., where the taxpayer has a possessory interest. This would limit a taxpayer from using HomeSA benefits if they have a possessory interest in another dwelling. Additionally, 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.

Section 17141.7(c) provides that any amount withdrawn from a first-time HomeSA is included in taxable income unless the payment or distribution is used to pay for qualified homeownership savings expenses. Under current law, interest earned on a bank account is generally taxed when the interest has been paid or accrued. However, since the funds deposited into the account are post-tax funds, the funds themselves are not taxable when the money is withdrawn, or the account is closed. By requiring funds, if not used for qualified expenses or withdrawn after January 1, 2030, the provisions would subject taxpayers to double taxation on money distributed from the account. As such, this could result is a disincentive to put money into a HomeSA. If this is contrary to the author's intent, the author may wish to amend the bill to limit the amount included in taxable income to the interest or other amounts accruing to the first-time HomeSA in excess of the amount contributed.

**LEGISLATIVE HISTORY**

AB 1317 (Brough, 2019/2020), AB 2115 (Brough, 2019/2020), AB 1758 (Steinorth, 2017/2018), and AB 1979 (Bonta & Steinorth, 2017/2018), 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), 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.

**OTHER STATES' INFORMATION**

None noted.

**FISCAL IMPACT**

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*

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1865 as Amended April 18, 2024  
 Assumed Enactment after June 30, 2024

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2024-2025	-\$0.83
2025-2026	-\$1.5
2026-2027	-\$1.7

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*

Based on reports from the California Association of Realtors, U.S. Census Bureau, and other available data, it is estimated that an average of 400,000 housing units are sold in California every year. Research indicates that nearly 45%, or 180,000 housing units, are sold to individuals who had no prior ownership in a principal residence in the preceding three years. Of these individuals, it is assumed that 20% of prospective home buyers would learn about the benefits of first-time HomeSAs and make contributions several years before purchasing a principal residence. Taking into account the timing of home purchase plans, it is estimated that 35,000 accounts would be opened by the end of 2025. Of these, it is assumed that those who plan to purchase a home within a 12-month period would contribute an average of \$100,000, those who plan to purchase a home within a 24-month period would contribute \$40,000, and those who plan to purchase a home within the next five years would contribute \$12,000.

It is estimated that qualified taxpayers would make \$1.1 billion in qualified contributions and have interest earnings of \$30 million in the 2025 taxable year. Applying the average tax rate of 7.5%, the estimated revenue loss would be \$2.3 million in taxable year 2025. It is further assumed that about 1%, or \$10 million, of the amounts deposited into first-time HomeSAs would not be used for qualified expenses and would be taxable, resulting in a net revenue loss of \$1.4 million for the 2025 taxable year. The revenue loss would grow to an estimated \$2 million over the next four years.

Of the amounts deposited over the life of the program, it is estimated that about 5%, or \$145 million, would remain in the accounts at the end of the program and would be returned to the individuals. Applying the average tax rate of 7.5%, the estimated revenue gain would be \$10 million in taxable year 2030.

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

### **LEGAL IMPACT**

None noted.

### **EQUITY IMPACT**

None noted.

### **APPOINTMENTS**

None noted.

**SUPPORT/OPPOSITION**

Assembly Committee on Revenue and Taxation's Analysis 04-26-2024

*Support*

- California Association of Realtors
- California Building Industry Association
- California Catholic Conference
- California Credit Union League
- Habitat for Humanity California
- Habitat for Humanity Greater Fresno Area
- Housing Action Coalition (UNREG)

*Opposition*

California Federation of Teachers AFL-CIO and California Teachers Association

**ARGUMENTS***Proponents*

Per the same analysis, the California Association of Realtors in support of this bill notes, in part, the following argument: "Ultimately, the lack of continued investment and resources that would help more first-time buyers save and purchase a home has led to California ranking third-lowest in statewide ownership rates. Data from the National Association of REALTORS® reports that Black/African Americans are using 401k/pension (17%) for their down payment which is higher than any other group. As we seek to solve our state's wealth gap among our diverse communities it is important that California offers resources to bridge the wealth gap."

*Opponents*

Per the same analysis, the California Teachers Association in opposition to this bill notes, in part, the following argument: "According to the Department of Finance, the state provided over \$87.5 billion in General Fund tax expenditures in 2023-24 (including income, sales and use, corporate and other taxes). This number continues to grow each year. This revenue would have otherwise gone to the General Fund, of which approximately 39 percent would have gone toward Proposition 98 for K-14 education. This means approximately \$34 billion is redirected away from schools and community colleges each year due to existing tax expenditures. While we understand these bills are well intended, CTA does not support this approach, as it would reduce overall funding for education."

**LEGISLATIVE CONTACT**

[FTBLegislativeServices@ffb.ca.gov](mailto:FTBLegislativeServices@ffb.ca.gov)