STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Ward, et al.

Sponsor:

Bill Number: AB 1932

Related Bills: See Legislative History

Amended: April 3, 2024

SUBJECT

Secondary Residence Mortgage Interest Deduction Disallowance – Housing, Homeownership, and Homelessness Prevention Fund

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), disallow the home mortgage interest deduction on a residence other than the taxpayers' principal residence and would require the Franchise Tax Board (FTB) to annually estimate and report to the State Controller's Office (SCO), the estimated additional amounts of tax revenue.

In addition, this bill would, under the Health and Safety Code (HSC), create the Housing, Homeownership, and Homelessness Prevention Response Fund (HHHPR Fund).

RECOMMENDATION

No position—The FTB has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

The April 3, 2024, amendments added coauthors, removed provisions of the HSC related to a California Statewide Housing Plan, and replaced them with the provisions discussed in this analysis.

This is the FTB's first analysis of the bill and only addresses the provisions that would impact the FTB.

REASON FOR THE BILL

The reason for the bill is to eliminate the mortgage interest deduction on a second residence and create the HHHPR Fund.

ANALYSIS

For taxable years beginning on or after January 1, 2025, 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, 2024, and before January 1, 2025, 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, 2025.

This bill would also, no later than June 1, 2026, and annually thereafter, require the FTB in consultation with 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 SCO be notified of that amount.

Additionally, this bill would create the HHHPR Fund within the State Treasury (Treasury). The bill would require the FTB to notify the Controller when it has estimated the following:

Upon receiving notification from the FTB, the SCO would be required to transfer the estimated funds from the General Fund to the HHHPR Fund. This bill provides that the HHHPR Fund would be continuously appropriated, without regard to fiscal years, as follows:

- Fifty percent of the moneys would be used in accordance with the Multifamily Housing Program.
- Twenty-five percent of the moneys would be used for supporting homeownership opportunities for first-time homebuyers.
- Twenty-five percent of the moneys would be used for distribution to local public housing authorities to provide housing navigation services and landlord incentives for housing voucher recipients.

Effective/Operative Date

This bill would be effective January 1, 2025, and specifically operative for taxable years beginning on or after January 1, 2025.

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

The bill requires the FTB to notify SCO by June 1, 2026, 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 FTB 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. The FTB data would be limited to the information provided by the taxpayers on the new form or worksheet.

The bill states the different areas a portion of the HHHPR funds should be used for, but it is silent as to which organizations or agencies the fund should be allocated to. For purposes of clarity, oversight, and ease of administration, it is recommended that the bill be amended.

Technical Considerations

None noted.

Policy Considerations

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 2616 (Lee, 2023/2024), similar to this bill, would, under PITL, also disallow the home mortgage interest deduction on a residence other than the taxpayers' principal residence and would require the FTB to annually estimate and report to the SCO, the estimated additional amounts of tax revenue. AB 2616 is currently in the Assembly pending referral.

AB 946 (Lee, 2021/2022) and 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 have been required to transfer such amounts from the General Fund to a new state fund created to address homelessness in California. AB 945 and AB1905 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 modified the existing Low-Income Housing Credit (LIHC). AB 71 did not pass out of the Assembly by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

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

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 1932 as Amended on April 3, 2024
Assumed Enactment after June 30, 2024

($ in Millions)

Fiscal Year	Revenue
2024-2025	$110
2025-2026	$190
2026-2027	$190

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 home mortgage interest deduction is reported on the tax return as the total deductible interest from both primary and secondary homes. Using home mortgage interest deduction data, it is estimated that taxpayers would report $65 billion in total, primary and secondary, mortgage interest deductions in taxable year 2025. Using data from the U.S. Census Bureau, it is estimated that 3 percent, or $1.9 billion, in mortgage interest deductions would be from second homes. After applying an average tax rate of 9.4 percent, the estimated revenue gain from the elimination of second home mortgage interest deduction would be $180 million for taxable year 2025.

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 Revenue and Taxation Committee Analysis 04-19-2024

Support:

All Home, a Project of Tides Center; Brilliant Corners; California Housing Partnership Corporation; Community Corporation of Santa Monica; Homes & Hope; Housing California; MidPen Housing Corporation; Nonprofit Housing Association of Northern California; Resources for Community Development; Sacramento Housing Alliance; Southern California Association of Non-profit Housing; United Way of Greater Los Angeles.

Opposition:

California Association of Realtors; California Mortgage Bankers Association; California Taxpayers Association.

ARGUMENTS

Proponents: None on file

Opponents: None on file

LEGISLATIVE CONTACT

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