Date of Hearing: April 11, 2018

ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT
David Chiu, Chair
AB 1979 (Bonta) – As Introduced January 31, 2018

**SUBJECT**: Personal income taxes: deduction: homeownership savings accounts

**SUMMARY**: Creates a homeownership savings account (HSA), beginning January 1, 2018, to provide similar tax benefits to an individual retirement account (IRA). Specifically, **this bill**:

1) Allows a taxpayer to create a HSA.

2) Excludes from gross income any income accruing to a HSA.

3) Makes a taxpayer's annual contribution to a HSA tax deductible.

4) Provides that a deduction would be allowed for contributions to a HSA as a miscellaneous itemized deduction not to exceed the following amounts:

   a) $30,000 for qualified taxpayers filing joint a return, a head of household or surviving spouses. For qualified taxpayers whose adjusted gross income (AGI) exceeds $150,000 during the taxable year, the deduction allowed would be reduced by $1 for each $4 of AGI in excess of $150,000; and

   b) $15,000 in the case of a qualified taxpayer filing a return other than as described in a). For qualified taxpayers whose AGI exceeds $80,000 during the taxable year, the deduction allowed would be reduced by $1 for each $4 of AGI in excess of $80,000.

5) Provides that for each taxable year beginning on or after January 1, 2019, the deduction amounts would be annually adjusted by the Franchise Tax Board (FTB) in the same manner as the income brackets, except that the amounts would be adjusted to the nearest $100.

6) Provides that any amount withdrawn from a HSA would be included in the income of the payee or distributee for the taxable year in which the payment or distribution is made, unless the payment or distribution is used within 120 days to pay for the qualified homeownership savings expenses of a qualified beneficiary.

7) Defines a HSA as a trust that meets all of the following requirements:

   a) Is designated as a HSA by the trustee;

   b) Is established for the exclusive benefit of any qualified beneficiary establishing the account where the written governing instrument creating the account provides for the following:

      i. All contributions to the account are required to be in cash and may be made by any person;

      ii. The account is established to pay, subject to limitations as specified, the qualified savings expenses of a qualified beneficiary;

iii. Is subject to the same limitations as an IRA; and

iv. Requires a qualified beneficiary to be designated by April 15 of the year following the taxable year in which the account was established and may be the qualified taxpayer. The qualified beneficiary designated may be changed at any time but no more than one qualified beneficiary may be designated for an account at any time. Married spouses qualify as one beneficiary.

8) Includes the following definitions:

   a) "Qualified beneficiary" means any individual, or individual's spouse, who has never had an ownership interest in a principal residence during the preceding three-year period ending either on the date the HSA is established or on the date of the individual's, or individual's spouse's, purchase of the principal residence for which any amount is withdrawn from the HSA.

   b) "Qualified homeownership savings expenses" means a disbursement listed on a settlement statement for the purchase of a single-family residence by a qualified beneficiary, the downpayment for that residence, and the costs of construction, or financing the construction of a single-family residence.

   c) "Qualified taxpayer" means an individual who establishes a HSA, individually or jointly with one or more other individuals.

   d) "Single-family residence" means a single-family residence located in this state and owned and occupied by or to be occupied by a qualified beneficiary as the qualified beneficiary's principal residence, which may include a manufactured home, trailer, mobile home, condominium unit, townhome, or cooperative.

   e) "Trustee" means the same as for an IRA.

9) Provides that an individual may do any of the following:

   a) Jointly own a HSA with another person if the joint account holders file a joint return;

   b) Be the account holder of more than one HSA but not hold or own multiple accounts that designate the same qualified beneficiary; and

   c) Be designated as a qualified beneficiary on more than one HSA.

10) Provides that a taxpayer may not use the funds in the HSA to pay expenses of administering the account other than a service fee that may be deducted by a financial institution.

11) Allows a taxpayer to withdraw funds in whole or in part from the HSA and deposit funds in another HSA.

12) Requires a qualified taxpayer to submit to the FTB in the form and manner required by the FTB detailed information regarding the account including the following:

   a) A list of transactions for the account during the taxable year;

b) The Form 1099 issued by the financial institution for the account for the taxable year;

c) A detailed account of the qualified HSA expense for which the account funds were withdrawn and expended; and

d) A statement of the amount of funds remaining in the account if any.

13) Requires the FTB to establish a process for a qualified taxpayer to notify the FTB of the HSA, the account holder, or holders, transfers, and the qualified beneficiary. Provides that this information may be included on a qualified taxpayer's tax returns or other means deemed appropriate by the FTB.

14) Provides that a financial institution is not required to take an action to ensure compliance with these provisions including designating an account, a beneficiary, or report any information to the FTB, or any other state agency unless required by law.

**EXISTING LAW**:

1) Provides for two types of IRAs under federal law, to which state law automatically conforms: traditional IRAs and Roth IRAs. The total amount of qualified contributions to both traditional and Roth IRAs are limited to the lesser of $5,500 ($6,500 for taxpayers 50 years of age or older), or the taxpayer's taxable compensation for the year.

2) Allows an income tax deduction for contributions (other than a rollover contribution) made only to a traditional IRA. In contrast, contributions made to a Roth IRA are not deductible and are subject to tax.

3) Provides that amounts held in a traditional IRA are generally includible as gross income when withdrawn. In contrast, qualified distributions from a Roth IRA are excludable from gross income (although interest earned on contributions is taxable if withdrawn for a non-qualified distribution).

4) Provides that withdrawals from a traditional IRA and non-qualified withdrawals of interest income from a Roth IRA are generally subject to an additional tax of 10% under federal law and 2.5% under state law if withdrawn prior to age 59 ½, death, or disability, with some exceptions. Most notably, the taxpayer is not subject to the early withdrawal tax if the withdrawal is used for first-time homebuyer expenses of up to $10,000. Such first-time homebuyer expenses of up to $10,000 are also included as "qualified distributions" from a Roth IRA.

5) Allows various other deductions and exclusions under federal law, to which state law generally conforms, in computing taxable income. Individuals may claim the standard deduction, a fixed dollar amount intended to approximate deductible living expenses, or itemized deductions for various specific expenses, including miscellaneous itemized deductions that are only allowed to the extent that they exceed 2% of adjusted gross income (AGI). Contributions to or withdrawals from a savings account for homeownership expenses are not generally deductible or excludible from income under federal or state law.

**FISCAL EFFECT**: Unknown.

**COMMENTS**:

Background*:* California has the third lowest homeownership rate in the country. Between 2006 and 2014, the number of housing units that were owner-occupied fell by almost 250,000 in California, while the number of renter-occupied units increased by about 850,000. According to the Public Policy Institute of California, "much of the increase in rental units occurred among formerly owned single family detached housing units." Despite this trend the state continues to make its most significant investment in housing through the mortgage interest deduction on primary residences. The FTB estimates that the impact of the mortgage interest deduction on state revenues for 2016-2017 was $5 billion dollars.

This bill would allow a taxpayer to set up a HSA similar to an IRA. Taxpayers would be authorized to deduct the amount they contribute to a HSA from their taxes. A taxpayer that files jointly, a head of household, and surviving spouses could deduct $30,000, but if their income exceeds $150,000 the deduction would be reduced by $1 for each $4 of adjusted gross income over $150,000. All other taxpayers could deduct $15,000, but if their income exceeds $80,000 during the taxable year, the deduction allowed would be reduced by $1 for each $4 of adjusted gross income over $80,000. Taxpayers who have not owned a home within the last three years would be eligible for the HSA program.

Funds for homeownership programs: Last year, the Legislature passed a package of bills to address the housing affordability crisis that includes SB 3 (Beall) Chapter 365, Statutes of 2017, the Veterans and Affordable Housing Bond Act of 2018 which will go before the voters in November of 2018. The bond includes a total of $450 million for homeownership programs. If approved, $150 million will go to the California Housing Finance Agency (CalHFA) for downpayment assistance for first-time homebuyers and $300 million for the CalHOME program to fund homeownership programs including self-help mortgage assistance. SB 2 (Atkins) Chapter 364, Statutes of 2017, which creates a permanent funding source for affordable housing program through a $75 recording fee on real estate documents (excluding those at the time of sale of a property) directs 70% of the funding in year two and beyond to locals to address affordable housing needs, including homeownership.

Tax-Advantaged Savings Accounts and Retirement Plans: Congress has authorized several types of retirement savings plans that qualify for reduced or deferred income taxes to encourage workers to save for retirement. For example, traditional IRAs allow for investment of a portion of wages on a pre-tax basis that remains untaxed until the money is withdrawn. Roth IRA investment contributions are made on an after-tax basis, but allow for tax-free qualified distributions (with interest earned on contributions subject to tax and penalty if withdrawn for a non-qualified distribution).

Existing federal law imposes a 10% withdrawal penalty on early distributions made from an IRA to a taxpayer under the age of 59 ½. California imposes a similar penalty but at the rate of 2.5%. However, recognizing that some significant event might require people to withdraw money from their retirement accounts earlier than expected, Congress has provided for a waiver of the early withdrawal penalty in some situations, to which California has conformed. Most notably, an exception from the penalty applies to distributions up to $10,000 that are used for first-time home purchases, and such distributions are also included as a "qualified distribution" from a Roth IRA.

The "First-Time Homebuyer" Exception: Under federal and state law, first-time homebuyers are authorized to make penalty-free withdrawals of up to $10,000 of IRA funds. The $10,000 limitation applies on an individual basis, meaning that both the taxpayer and the taxpayer's spouse may qualify individually for this first-time homebuyer exception, potentially doubling the amount of money withdrawn without penalty. The definition of "first-time homebuyer" is broad and includes a taxpayer who previously owned a home, so long as the taxpayer has no present interest in a main home during the two-year period ending on the date of acquisition of the home which the distribution is being used to buy. Furthermore, the taxpayer does not have to purchase the residence for her/himself, as the penalty-free withdrawal could be used to help a child, grandchild, or parent buy a home. Given the existing allowance of penalty-free withdrawals from IRAs for first-time homebuyers, the Committee may wish to consider whether creating a new tax-advantaged savings account for homeownership is necessary.

Purpose of this bill: According to the author, "under AB 1979 individuals earning up to $80,000 and joint filers earning up to $150,000 would receive a dollar for dollar deduction to their adjusted gross income for deposits made into officially designated first-time homeownership savings accounts. For prospective first-time homeowners whose income exceeds those limits, the deduction would be reduced to $1 for every $4 saved. Joint filers could save up to $30,000. The contribution limit for individual filers would be $15,000. Any funds withdrawn from the account must be used for qualified homeownership expenses or will be considered regular income and taxed accordingly. Qualified homeownership expenses include down payment, closing costs, or costs of construction for a single-family residence. This bill would make it possible for first-time home buyers to save money for a home, bringing the dream of homeownership within reach."

Committee amendments:

Unlike other homeownership programs the state administers, like the programs operated by CalHFA, the funding for this program would come from a reduction in state revenues and would be a one-time investment in one individual rather than function as a revolving loan fund. The committee may wish to consider if this is the right investment considering the affordable housing challenges facing the state. The committee may wish to consider whether there should be some income limitation on those who can qualify for a HSA to focus this bill on lower income individuals.

- Only allow taxpayers that make up to 80% of AMI qualify to create a HSA. If a taxpayer's income exceeds 80% AMI in any given year they cannot contribute to the HSA.

- Change the definition of "first time homebuyers" from taxpayers that have not owned a home within the last three years to a taxpayer who has never owned a home.

- The bill does not specify that a HSA must be closed once a purchase is made. The committee may wish to consider an amendment to clarify that once a home is purchased it must be closed.

- The definition of "qualified homeownership savings expenses" is overly broad and could include expenses for repairs, renovations, the purchase of new appliances and soft goods, and moving expenses in addition to potentially on-going mortgage payments. The committee may wish to clarify that "qualified homeownership savings expenses" is limited to down payment and closing costs.

Related legislation*:* AB 1758 (Steinorth) (2018) would create an individual homeownership savings account that would include income tax benefits similar to an IRA. The bill is pending hearing in this committee.

Prior legislation:

AB 53 (Steinorth) (2017) would have created an individual homeownership savings account that would have included income tax benefits similar to an IRA. This bill failed passage in the Assembly Appropriations Committee.

AB 1736 (Steinorth) (2016) would have created an individual homeownership savings account that would have included income tax benefits similar to an IRA. This bill failed passage in the Assembly Appropriations Committee.

Double-Referred: If AB 1979 passes out of this committee, the bill will be referred to the Committee on Revenue and Taxation

**REGISTERED SUPPORT / OPPOSITION**:

**Support**

APEN
California Association of Realtors
California Credit Union League
Greenlining Institute
Habitat for Humanity California

**Opposition**

None on file

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