STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Ochoa Bogh, et al.

Sponsor:

Related Bills: See Legislative History

Bill Number: SB 601

Amended: May 20, 2021

SUBJECT

Increase Capital Gain Exclusion for Sale of a Principal Residence to First-Time Homeowners

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), increase the maximum amount of the income exclusion on the sale of a principal residence, when the buyer is a first-time homeowner.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 20, 2021, amendment specified that the increase in a seller's maximum excludable gain on the sale of a principal residence would only be operative for taxable years for which resources are authorized in the annual Budget Act or other statute for specified purposes. This created an additional implementation consideration.

REASON FOR THE BILL

The reason for the bill is to provide an incentive to owners of principal residences to sell their property to first-time homeowners by increasing the maximum amount of gain excluded from gross income.

ANALYSIS

This bill would, on or after January 1, 2021, and before January 1, 2026, increase the seller's maximum excludable gain on the sale of a principal residence that may be excluded from gross income from $250,000 to $300,000 for single filers, and from $500,000 to $600,000 for joint return filers and surviving spouses, for the sale of a qualified principal residence to a certified first-time homeowner.

For purposes of the increased exclusion, this bill would define the following terms:

"Qualified first-time homeowner" would mean any individual (and, if married, that individual's spouse) who had no ownership interest in a principal residence during the preceding three-year period ending on the date of the purchase of the qualified principal residence. For this purpose, a qualified first-time homeowner does not include any individual, his or her spouse, or both, if they are treated as a "related party" to the seller.

"Qualified principal residence" would mean a single-family residence, whether detached or attached, that is purchased to be the principal residence of a qualified first-time homeowner for a minimum of two years and is eligible for the homeowner's property tax exemption under Revenue and Taxation Code (RTC) section 218.

The increased exclusion would be allowed subject to the seller obtaining from the buyer on or before the closing date of the sale or exchange of the qualified principal residence, a written certification that includes all of the following:

- The buyer's name, taxpayer identification number, and address;
- The seller's name, taxpayer identification number, and address;
- The address and sales price of the qualified principal residence; and
- An affirmative representation by the buyer, which verifies that the buyer meets the requirements to be a qualified first-time homeowner, including a representation that the buyer has not owned a qualified principal residence during the three-year period ending on the closing date of the purchase of the qualified principal residence.

The increased exclusion would only be operative for taxable years for which the resources are authorized in the annual Budget Act or other statute for the Franchise Tax Board (FTB) to oversee and audit returns associated with the exclusion of gain from the sale of a principal residence to a qualified first-time homeowner.

To meet the requirements of Section 41 of the RTC, the bill states that the goals, purposes, and objectives of the increased exclusion from gross income would be to help level the playing field for first-time homebuyers and to get more first-time homebuyers into homes. The number of taxpayers utilizing the increased exclusion would be used to measure the effectiveness of credit.

This bill would require the Legislative Analyst Office (LAO) to collaborate with the FTB to review the effectiveness of the increased exclusion from gross income. The review would include analysis of the demand and the economic impact of the increased income exclusion.

This bill would allow the LAO to request and the FTB to provide any information necessary to review the effectiveness of the increased exclusion from gross income. Any information provided that has not otherwise been made public would remain confidential taxpayer information prohibited from disclosure. The LAO would be required to publish the finding of the review by December 1 of an unspecified year.

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, 2021, and before January 1, 2026. In addition, this bill would only be operative for taxable years for which resources are authorized in the Budget Act or other statute for FTB to oversee and audit returns associated with the increased exclusion.

Federal/State Law

Federal Law

Gross income means all income from whatever source derived, including gains from dealings in property, unless specifically excluded.

Gain from the sale or exchange of property is excluded from gross income if, during the five-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more.

Limitation

The amount of gain excluded from gross income with respect to any sale or exchange of a principal residence is limited to $250,000.

In the case of taxpayers who file a joint return for the tax year of the sale or exchange of the property, the $250,000 limitation (described above) that applies to the exclusion of gain from the sale or exchange of a principal residence becomes $500,000 if:

- Either spouse meets the ownership requirements with respect to the property;
- Both spouses meet the use requirements with respect to the property; and
- Neither spouse is ineligible for the benefits of the exclusion with respect to the property because of the one sale every two years rule.

A surviving spouse may exclude from gross income up to $500,000 of the gain from the sale or exchange of a principal residence owned jointly with a deceased spouse if the sale or exchange occurs within two years of the death of the spouse.

State Law

California imposes an income tax on the entire taxable income of residents of this state. Nonresidents of California must include income from sources within this state, including gains realized from the sale or transfer of property located within this state.

California conforms, under the PITL, to Internal Revenue Code (IRC) section 61, relating to gains from dealings in property, and to IRC section 121, relating to exclusion of gain from the sale of principal residence, as of the "specified date" of January 1, 2015, with modifications unrelated to the provisions of this bill.

Under RTC section 41, 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.

Implementation Considerations

A tax benefit that is funded in a budget subsequent to the start of the filing season may result in a need for taxpayers to file amended returns to obtain the benefit proposed by the bill. For example, if this bill is signed in fall 2021, the budget will have already passed so the earliest funding, for the tax year of 2022, could be provided is in mid-2023.

Additionally, the department requires lead time for forms development, system updates, and staff training, as applicable. Because funding was not provided for in fiscal year 2021-2022, the FTB would be unable to implement this bill for taxable year 2021. Should the funding be provided for in fiscal year 2022-2023, the FTB would be able to develop forms, implement system changes, and train staff in time for the 2022 taxable year. However, should funding be interrupted in the 2023-2024 fiscal year, the FTB would be required to treat taxpayers who filed before July 1 differently than those who file July 1 and later. The differences in timing for the taxable and fiscal years can cause implementation challenges and create uncertainty in this process for both the department and taxpayers.

Based on these concerns and for ease of administration, it is recommended that an alternative metric be employed upon which the tax benefit could be allowed or not and one that provides greater certainty as to the exclusion.

Technical Considerations

RTC section 41 of this bill does not specify a year that the LAO would be required to publish the finding of the effectiveness of the increased exclusion from gross income review.

Policy Considerations

This bill would create additional differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

Additionally, there will be uncertainty for taxpayers as to the exclusions due to the contingencies in the bill, which could affect taxpayer behavior.

LEGISLATIVE HISTORY

SB 401 (Wolk, Chapter 14, Statutes of 2010) changed the specified date from January 1, 2005, to January 1, 2009, for taxable years beginning on or after January 1, 2010, which among other things, conformed to federal law that allows surviving spouse to exclude from gross income up to $500,000 of the gain from sale of principal residence if the sale occurs within 2 years of the death of the spouse.

SB 1116 (Moorlach, 2017/2018), substantially similar to this bill, would have, under the PITL, increased the maximum amount of the income exclusion on the sale of a principal residence, when the buyer is a first-time homeowner. SB 1116 did not pass out of the Senate Committee on Appropriations.

AB 1806 (Hagman, 2009/2010), would have provided conformity to the federal capital gain exclusion from gross income on the sale of a personal residence by a surviving spouse. AB 1806 did not pass out of the Assembly Revenue and Taxation Committee.

SB 1416 (Walters, 2009/2010) would have provided an exclusion from gross income, without limitation, for gain on the sale or exchange of a principal residence by a taxpayer 65 years or older. SB 1416 did not pass out of the Senate Revenue and Taxation Committee.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 601 as Amended May 20, 2021.
Assumed Enactment after June 30, 2021

($ in Millions)

Fiscal Year	Revenue
2021-2022	-$120
2022-2023	-$80
2023-2024	-$85

Estimated revenue amounts assume resources are authorized in the annual Budget Act or other statute for the FTB.

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

The Senate Floor analysis dated May 25, 2021, lists the following support and opposition.

Support: California Association of Realtors, Howard Jarvis Taxpayers Association, Inland Gateway Association of Realtors, Inland Valleys Association of Realtors, and Livable California.

Opposition: California Federation of Teachers, California School Boards Association, and California Tax Reform Association.

ARGUMENTS

Arguments in Support

According to the May 25, 2021, the Senate Floor analysis of SB 601, the author believes this bill would increase chances for first-time homeowners to purchase the house in California:

> SB 601 is a step in the right direction towards leveling the playing field for first-time homeowners. It would do so by allowing homeowners who sell their homes to a first-time homebuyer to exclude capital gains of $300,000 for single filers instead of the current $250,000 maximum and $600,000 for joint filers instead of the current $500,000 maximum from their gross income. California is in the midst of a housing crisis. With the median price of a single family home being $693,690 in 2020 (more than twice the national average), an analysis done by the California Association of Realtors showed that only 28% of households could afford a home at this price. The cause of these high prices is mostly due to a severe lack of housing supply to meet increasing demand. One of the many consequences of this supply shortage is an extremely competitive market for potential home buyers, especially buyers looking to purchase their first home. In fact, California ranked as the toughest state in the nation for first-time home buyers according to a report done by bankrate.com. The report names a number of reasons for this ranking: the relatively high cost of housing, the tight market for available entry-level homes and the struggle that millennials face in saving for a down payment. Homeownership is the bedrock of the American dream. Too many young people are seeing this dream move further and further out of their reach due to the high cost of housing in California. SB 601 is one small step we can take towards making that dream more attainable for these hard working Californians.

Arguments in Opposition

According to the May 25, 2021, the Senate Floor analysis of SB 601, the California Tax Reform Association contends that this measure would disproportionately benefit wealthy property owners and cost the state General Fund millions of dollars:

> While most efforts to incentive first-time home purchases provide a direct benefit to the buyers, this measure would instead disproportionately benefit wealth property owners, who already benefit from numerous programs to assist homeowners, such as Proposition 13. This, of course, in addition to the equity a property owner obtains upon the sale of their home. Effective tax exemption programs incentivize activity that otherwise would not have occurred. Because first time home buyers are highly motivated to purchase a home, and receive no direct benefit from this proposed program, it seems unlikely that this measure would result in a purchase that would have not otherwise occurred. Instead, this measure SB 601 Page 5 would cost the state General Fund millions of dollars which could have otherwise directly benefited those most in need of housing in the state.

LEGISLATIVE CONTACT

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