Date of Hearing: June 6, 2022

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Jacqui Irwin, Chair

SB 601 (Ochoa Bogh) – As Amended May 20, 2021

FOR TESTIMONY ONLY

Majority vote. Tax levy. Fiscal committee.

SENATE VOTE: 39-0

SUBJECT: Personal income taxes: exclusions: capital gains: sale of residence

SUMMARY: Increases, under the Personal Income Tax (PIT) Law, the maximum amount of the income exclusion on the sale of a principal residence when the buyer is a first-time homeowner. Specifically, **this bill**:

1) Revises, for taxable years beginning on or after January 1, 2021, and before January 1, 2026, the exclusion to provide that if the buyer of a qualified principal residence located in California is a "qualified first-time homeowner," the amount of the exclusion is increased from $250,000 to $300,000 for taxpayers who are single or married filing separately, and from $500,000 to $600,000 for taxpayers who are married filing jointly, or a surviving spouse.

2) Defines a "qualified first-time homeowner" as 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 closing date of the purchase of the qualified principal residence.

3) Specifies that a "qualified first-time homeowner" does not include any individual, their spouse, or both, if the individual and their spouse are treated as a "related party" to the seller under Internal Revenue Code (IRC) Sections 267, 318, or 707, relating to losses, expenses, and interest concerning transactions between related taxpayers, constructive ownership of stock, and transactions between partner and partnership.

4) Defines a "qualified principal residence" as 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 exemption under [Revenue and Taxation Code (R&TC)] Section 218.

5) Provides that 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:

   a) The buyer's name, taxpayer identification number, and address;

   b) The seller's name, taxpayer identification number, and address;

   c) The address and sales price of the qualified principal residence; and,

   d) 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.

6) Provides that the increased exclusion would only be operative for taxable years for which 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.

7) Provide the following provisions for purposes of satisfying the requirements of R&TC Section 41:

   a) The Legislature finds that the goals, purposes, and objectives of this bill are to help level the playing field for first-time homebuyers, and to get more first-time homebuyers into homes;

   b) Performance indicators for this bill shall be the number of taxpayers utilizing the increased exclusion;

   c) The Legislative Analyst shall collaborate with the FTB to review the effectiveness of the increased exclusion and shall publish its findings by December 1 of an unspecified year. The review shall include, but is not limited to, an analysis of the demand for the increased exclusion and the economic impact of the increased exclusion;

   d) Notwithstanding R&TC Section 19542, the Legislative Analyst may request, and the FTB may provide, any information necessary in carrying out the duties of the Legislative Analyst's Office in this bill; and,

   e) Any information received by the Legislative Analyst's Office in this bill, that has not otherwise been made public, shall be considered confidential taxpayer information subject to R&TC Section 19542.

8) Provides that no reimbursement is required by this bill.

9) Takes effect immediately as a tax levy.

EXISTING LAW allows, in modified conformity to federal income tax laws, taxpayers to exclude from their gross income up to $250,000 or $500,000, depending on the taxpayers' tax return filing status, of gain realized on the sale or exchange of their residence if the taxpayer owned and occupied the residence as a principal residence for an aggregate period of at least two of the five years prior to the sale or exchange. (R&TC Section 17152.)

FISCAL EFFECT: FTB estimates that this bill would result in General Fund revenue losses of $120 million in Fiscal Year (FY) 2021-22, $80 million in FY 2022-23, and $85 million in FY 2023-24.

COMMENTS:

1) The author has provided the following statement in support of this bill:

   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. This is something I saw firsthand in my long time career as a realtor. 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.

   In this type of market, cash buyers have a decisive edge. According to ATTOM Data Solutions, 15-20% of sales between 2000 and 2007 were all-cash sales. That number has increased dramatically over the years, and most recently set at 26.6% in 2020. Additionally, there has been a number of reports about the increase in large corporations buying a large percentage of houses.

   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 and lack of opportunity in California. SB 601 is one small step we can take towards making that dream more attainable for these hard working Californians.

2) This bill is supported by the California Association of Realtors, which notes, in part:

   Currently, California's statewide median home price in April of 2022 reached an estimated $884,890. This figure is up 4.2 percent from March, and up 8.7 percent from April 2021. SB 601 seeks to provide opportunities for prospective homebuyers to make their dreams of homeownership more attainable by providing incentives to existing homeowners.

3) Committee Staff Comments:

   a) *What would this bill do*? This bill would increase the current taxable income exclusion for taxpayers who sell their primary residence to a qualified first-time homeowner. The exclusion amount is increased from $250,000 to $300,000 ($50,000 increase) for single or married filing separately and from $500,000 to $600,000 ($100,000 increase) for taxpayers who are married filing jointly or a surviving spouse. This bill would remove California from federal conformity.

b) *Who potentially benefits from this bill*? This bill would benefit taxpayers who sell their qualified primary residence to a qualified first-time homeowner and have more capital gains than the current excluded amount from the sale. This bill would also benefit qualified first-time homebuyers who would not have their home purchase offer accepted, but for this bill incentivizing the seller.

c) *Removes federal conformity*: As noted in the Senate Committee on Governance and Finance's analysis of this bill, SB 601 would create a difference between federal and state tax treatment of a taxpayer selling their principal place of residence to a first-time homeowner.[1] This Committee generally removes conformity because federal conformity promotes simplicity and eases the burden of administering complex tax laws.

d) *Impact*: This bill encourages homeowners to sell their principal residence to first-time homebuyers by allowing the seller to exclude more capital gains from income tax, specifically $50,000 more for single taxpayers and $100,000 more for married taxpayers.

For example, married homeowners with a taxable income of $150,000 would potentially realize a state tax savings of $9,300 from a $100,000 taxable gain exclusion (based on a marginal tax rate of 9.3%) by selling their qualified home under this bill. Committee staff questions whether the potential tax savings that would result from this bill would be enough to incentivize homeowners to sell to first-time homebuyers.

In addition, the impact of this bill could be dependent on other factors, including sellers being aware of the benefits of this bill and sellers having attractive offers from qualified first-time homebuyers. This bill does not incentivize an increase in the overall housing supply. Instead, this bill makes first-time homebuyers' offers to buy a house marginally appealing by the potential state tax savings the sellers could realize from this bill.

e) *Effective use of state's revenue*: Committee staff questions whether tax policy is the most effective method to accomplish this bill's goals. Is giving a tax break to homeowners with significant capital gains the best way to help level the playing field for first-time homebuyers and get more first-time homebuyers into homes?

f) *Recommended changes*:

i) *Retroactivity*: This bill is effective from the 2021 taxable year. This Committee generally has not supported retroactive bills because those bills cannot influence or change taxpayers' past behaviors. Additionally, administering a retroactive bill may be complicated, and the taxpayers may have difficulty understanding and complying with amending their tax returns.

ii) *Budget contingency*: This bill is subject to another legislative act funding the costs of this bill. Therefore, the uncertainty of this bill's applicability may confuse taxpayers.

iii) *Unspecified year*: This bill has not specified a year when the Legislative Analyst's Office is required to publish its findings. Committee staff is available to assist the author specify a year.

[1] Deitchman, J. (2021). Committee analysis of SB 601 as amended on April 22, 2021.

g) *Committee's tax expenditure policy*: This bill complies with R&TC Section 41 because it outlines specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives.

   In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals have an appropriate sunset provision to be eligible for a vote. Sunsets are required because eliminating a tax expenditure generally requires a two-thirds vote. Accordingly, this bill contains a five-year sunset provision.

i) *Prior Legislation*: SB 1116 (Moorlach), of the 2017-2018 Legislative Session, is similar to this bill. SB 1116 was held on the Senate Committee on Appropriations' Suspense File.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association of Realtors
Howard Jarvis Taxpayers Association (HJTA)
Inland Gateway Association of Realtors
Inland Valleys Association of Realtors

Opposition

None on file

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