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California's Expansion of the Homebuyers' Tax Credit Program: Economic Stimulus or \$200 Million Giveaway?

Daniel S. Cucchi

Code Section Affected

Revenue and Taxation Code § 17059.1 (new).
AB 183 (Caballero); 2010 STAT. Ch. 12.

I. INTRODUCTION

California's economy is in a precarious position.¹ The state's unemployment rate is hovering around twelve percent.² State and local governments are facing dramatic budgetary shortfalls that are forcing government employees to take unpaid furlough days and face employment layoffs.³ A dramatic downturn in the housing market was a major factor that led to the "Great Recession."⁴ Some argue that turning this sector around is the key to economic recovery in the United States.⁵

Both California and the federal government created significant incentive programs to stimulate consumer activity in 2009,⁶ which began moving housing industry activity in a positive direction.⁷ As those programs start to expire,

1. Darrell Smith, *Job Losses Continue to Slow in Sacramento Region*, SACRAMENTO BEE, June 30, 2010, at 8B (on file with the *McGeorge Law Review*); see generally Paul Krugman, Op-Ed., *The Third Depression*, N.Y. TIMES, June 28, 2010, at A19.

2. Smith, *supra* note 1.

3. Lisa Lambert, *Analysis: States Turn from Furloughs to Layoffs*, REUTERS, July 1, 2010, <http://www.reuters.com/article/idUSTRE6604DY20100701> (on file with the *McGeorge Law Review*); Anne Lowe, *Sacramento County Board Moves Forward on Layoffs; More Cuts Ahead*, RANCHO CORDOVA POST, June 4, 2010, <http://www.ranchocordovapost.com/2010/06/04/county-board-moves-forward-on-layoffs-more-cuts-ahead/> (on file with the *McGeorge Law Review*).

4. Mortimer Zuckerman, Opinion, *The Great Recession Continues*, WALL ST. J., Jan. 21, 2010, at A19; see also Timothy R. Homan, *Shiller Says Government Support Is Tied to Housing Recovery*, BLOOMBERG BUS. WK., Feb. 23, 2010, <http://www.businessweek.com/news/2010-02-23/shiller-says-government-support-is-tied-to-housing-recovery.html> (on file with the *McGeorge Law Review*) ("Stabilization in U.S. home prices that may lay the foundation for a sustained recovery in . . . the industry that precipitated the worst recession since the 1930s . . .").

5. See Queenie Wong, *Home Builders: Homebuyer Tax Credit Key to Economic Recovery*, U.S. NEWS & WORLD REP., Aug. 28, 2009, <http://politics.usnews.com/news/national/articles/2009/08/28/home-builders-homebuyer-tax-credit-key-to-economic-recovery.html> (on file with the *McGeorge Law Review*) ("I'll go by the past, and in the past it's been the housing markets that have led the economy out of the recession.").

6. American Recovery and Reinvestment Act of 2009, § 1006, I.R.C. § 36 (Supp. 2010) (providing a federal homebuyer tax credit); CAL. REV. & TAX. CODE § 17059 (West 2010) (providing a state homebuyer tax credit).

7. Jim Wasserman, *2009 Tally: Sacramento-Area Home Sales, Prices Down*, SACRAMENTO BEE, Jan. 21, 2010, <http://www.sacbee.com/2010/01/21/2479551/2009-tally-sacramento-area-home.html> (on file with the *McGeorge Law Review*).

however, fears of a “housing double dip” are increasing.⁸ Chapter 12 seeks to build upon the government’s previous successes and expand the homebuyer credit program to spur economic activity in the new home construction market.⁹ It also aims to combat the “influx of foreclosed homes in communities across the state,” providing similar tax incentives for first-time homebuyers to purchase existing homes.¹⁰

II. LEGAL BACKGROUND

After experiencing an unprecedented rise in home values in the early to mid-2000s, a tidal wave of falling values, mortgage defaults, and credit freezes came crashing down in 2008.¹¹ Since then, California has continued to look for ways to right the economic ship.¹²

A. *The First Move*

As California faced a \$41 billion budget gap in early 2009, state lawmakers held a marathon budget session to reach an agreement to fix the financial crisis.¹³ The final agreement included a mixture of spending cuts, tax increases, and economic stimulus measures.¹⁴ Among the stimulus measures was SBX2 15, a \$10,000 tax credit for purchasers of new homes.¹⁵

SBX2 15 focused on the new home construction market.¹⁶ Taxpayers could receive a tax credit of up to \$10,000 for purchasing a home that was never previously occupied.¹⁷ To receive the credit, the purchase had to occur between March 1, 2009 and March 1, 2010,¹⁸ and the seller had to provide a certification that the home had not been previously occupied to the purchaser and the Franchise Tax Board (FTB) within one week of the sale, and the taxpayer had to

8. See Stephane Fitch, *Housing Double Dip Appears To Be Underway*, FORBES.COM, July 7, 2010, <http://www.forbes.com/2010/07/07/housing-double-dip-personal-finance-real-estate-dip.html> (on file with the *McGeorge Law Review*) (finding a late 2009 decrease in home value).

9. Background Sheet, Anna Caballero, Assembly Member, Cal. State Assembly, AB 183: Income Tax Credit: Purchase: Principal Residence (July 9, 2010) [hereinafter Background Sheet] (on file with the *McGeorge Law Review*).

10. *Id.*

11. See Jessica R. Lee, *Chapter 11: California’s New-Home Tax Credit: Rekindling the Dream for a Place of One’s Own*, 41 MCGEORGE L. REV. 773, 773-75 (2010) (describing the history of the “mortgage meltdown”).

12. See CAL. REV. & TAX. CODE § 17059 (West 2010) (providing a \$10,000 tax credit for purchasers of new homes); AB 765, 2009 Leg., 2009-2010 Sess. (Cal. 2009) (as amended on Sept. 4, 2009, but not enacted) (seeking to extend the homebuyer tax credit codified in CAL. REV. & TAX. CODE § 17059).

13. Lee, *supra* note 11, at 775-76.

14. *Id.* at 776.

15. *Id.*

16. CAL. REV. & TAX CODE §§ 17059(a)(1), (b)(1).

17. *Id.*

18. *Id.* § 17059(a)(1).

file a copy of the certification with his or her tax return.¹⁹ The Legislature allocated a total of \$100 million to the program.²⁰

B. “Let’s Keep a Good Thing Going”

The homebuyer tax credit generated a significant amount of activity in a short period of time.²¹ Homebuyers took all of the available tax credits within four months,²² and homebuilders hailed the program as a major success.²³ The FTB, however, discovered that taxpayers claimed only about seventy percent of the money even though the Legislature allocated \$100 million for the stimulus program because some homeowners had insufficient tax liability to offset the credit.²⁴

Originally introduced to address tax issues regarding research expenses,²⁵ the Legislature significantly amended AB 765 in early May 2009 to extend the program that began under SBX2 15.²⁶ While AB 765 was amended five additional times,²⁷ early versions set up a system allowing taxpayers to reserve the credit ahead of the actual sale.²⁸ The Assembly bill also proposed a system to ensure that the maximum credit was available to qualified taxpayers.²⁹ Ultimately, AB 765 stalled in the Senate,³⁰ but its concepts were later revived by Chapter 12.³¹

19. *Id.* § 17059(b)(2).

20. *Id.* § 17059(d).

21. See SENATE FLOOR, COMMITTEE ANALYSIS OF AB 765, at 2 (Sept. 9, 2009) (“Within four months of the effective date of the credit, FTB received 11,925 applications representing an excess of \$100 million in tax credits available for new home purchases.”).

22. *Id.*

23. See, e.g., J.N. Sbranti, *Tax Credit Gets Credit: Builders Say It’s Driving Sales of Homes, Call for Cap to Be Raised*, MODESTO BEE, June 19, 2009, at B6 (crediting the tax credit program for spurring increases in new home sales and construction).

24. SENATE FLOOR, COMMITTEE ANALYSIS OF AB 765, at 2 (Sept. 9, 2009); see also Investopedia.com, Non-Refundable Tax Credit, <http://www.investopedia.com/terms/n/nonrefundabletaxcredit.asp> (last visited Feb. 8, 2011) (on file with the *McGeorge Law Review*) (defining “insufficient tax liability”). Tax credits are a credit against taxes owed by the taxpayer. In situations where a taxpayer owes less than the tax credit, that taxpayer is considered to have an “insufficient tax liability” to take advantage of the entire credit amount. For example, if a taxpayer owes \$700 in taxes and receives a \$1,000 tax credit, that taxpayer would only receive \$700 in tax credits because the credit is larger than the amount owed. *Id.*

25. AB 765, 2009 Leg., 2009-2010 Sess. (Cal. 2009) (as introduced on Feb. 26, 2009, but not enacted).

26. *Id.* (as amended on May 11, 2009, but not enacted).

27. Complete Bill History of AB 765, http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_0751-0800/ab_765_bill_20090909_history.html (last visited July 16, 2010) [hereinafter Bill History of AB 765] (on file with the *McGeorge Law Review*).

28. AB 765, 2009 Leg., 2009-2010 Sess. (Cal. 2009) (as amended on May 11, 2009, but not enacted) (adding CAL. REV. & TAX. CODE § 17059(a)(4)).

29. See AB 765, 2009 Leg., 2009-2010 Sess. (Cal. 2009) (as amended on Sept. 4, 2009, but not enacted) (reducing available funds by only seventy percent of each tax credit in anticipation of unclaimed credits); SENATE FLOOR, COMMITTEE ANALYSIS OF AB 765, at 2-3 (Sept. 9, 2009) (“By reducing the total amount of credit available for allocation by 70 percent, this bill allows \$30 million to be allocated to other taxpayers, thereby ensuring that the General Fund impact of this program will be \$100 million over three years.”).

30. Complete Bill History of AB 765, *supra* note 27.

31. CAL. REV. & TAX. CODE § 17059.1(c)(1)(A), (f)(1)(A)-(B) (enacted by Chapter 12).

III. CHAPTER 12

Chapter 12 provides a non-refundable tax credit to qualified taxpayers equal to five percent of the purchase price of a qualified residence or \$10,000, whichever is less, divided equally over three years following the purchase.³² Any taxpayer can receive the credit in one of two ways: as a “first-time home buyer”³³ or by purchasing a principal residence that has never been previously occupied.³⁴ In either case, purchase made between May 1, 2010 and August 1, 2011 are eligible for the credit.³⁵ Any purchase completed after December 31, 2010, however, must be made pursuant to an enforceable contract executed on or before December 31, 2010.³⁶

Chapter 12 caps the maximum tax credit for the program at \$100 million each for both “first-time home buyers” and for purchasers of residences that have never been previously occupied.³⁷ For taxpayers that qualify as both “first-time home buyers” and purchasers of a principal residence that has never been previously occupied, the FTB must allocate the credit against the funds for residences that have never been previously occupied.³⁸

Chapter 12 also sets up a system to track the tax credit allocations.³⁹ The FTB allocates credit on a first-come-first-served basis.⁴⁰ Taxpayers can secure their place in the program by filing a certification with the FTB stating that they have entered into an enforceable contract that meets the program’s eligibility requirements.⁴¹ After individual home-buyers only claimed an average of seventy percent of the earmarked funds during SBX2 15, Chapter 12 earmarks only fifty-seven to seventy percent of the individual tax credit amount each time it receives notice of a new home sale until all program funds are reserved.⁴² Home buyers actually claim the tax credit when they file qualifying annual tax returns.⁴³

32. *Id.* § 17059.1(a)(1)-(2) (enacted by Chapter 12).

33. *Id.* § 17059.1(b)(2) (enacted by Chapter 12) (“any individual, or individual’s spouse, who had no present ownership interest in a principal residence during the preceding three-year period ending on the date of the purchase of the qualified principal residence”).

34. *Id.* § 17059.1(b)(1) (enacted by Chapter 12).

35. *Id.* § 17059.1(a)(1) (enacted by Chapter 12).

36. *Id.*

37. *Id.* § 17059.1(f)(1) (enacted by Chapter 12).

38. *Id.* § 17059.1(f)(3) (enacted by Chapter 12).

39. *Id.* § 17059.1(c)(1)(A), (f)(1)(A)-(B), (f)(2), (g)(1) (enacted by Chapter 12).

40. *Id.* § 17059.1(g)(1) (enacted by Chapter 12).

41. *Id.* § 17059.1(c)(1)(A) (enacted by Chapter 12).

42. SENATE FLOOR, COMMITTEE ANALYSIS OF AB 765, at 2 (Sept. 9, 2009)

43. *Id.* § 17059.1(f)(1)(A)-(B) (enacted by Chapter 12).

IV. ANALYSIS

As the Legislature witnessed the first positive signs in the housing market since the crash,⁴⁴ existing state and federal programs had expired or were in the process of winding down.⁴⁵ The question was whether injecting another stimulus into the housing market would provide the push necessary to keep the recovery going,⁴⁶ or whether it was “\$200 million in a deficit-plagued state . . . [that could be] better spent elsewhere.”⁴⁷

A. Stimulating Job Growth in the Housing Sector

Supporters believe that Chapter 12 is essential to California’s economic recovery.⁴⁸ They point to rises in median home values and stabilization of prices in the low end of the market to illustrate the success of government intervention.⁴⁹ There is, however, still some concern that the housing market could decline as the tax credit programs expire.⁵⁰ The answer, supporters say, is to keep these types of programs funded so California can continue its progress towards recovery.⁵¹

Supporters also argue that Chapter 12 does more than just spur home sales, pointing to studies indicating that the purchase of a new home also spurs job creation.⁵² Governor Arnold Schwarzenegger touts the law as a job creator and argues that Chapter 12 puts tradesmen back to work.⁵³ Supporters also contend that

44. See Wasserman, *supra* note 7 (describing “a dramatic ending to the traumatic free falls that frightened area homeowners throughout 2007 and 2008”).

45. See *id.* (“Spring [2009] brought . . . several months of a . . . \$10,000 state tax credit . . . [and the] federal tax credit expires at the end of April.”).

46. See Matt Wrye, *Group Seeks New Home Buyers’ Tax Credit*, INLAND VALLEY DAILY BULL., Jan. 31, 2010 (on file with the *McGeorge Law Review*) (“The California Building Industry argues . . . putting a second incentive into play would give the state’s economy and battered housing sector a much-needed boost.”).

47. Jim Wasserman, *Plan has \$200M for Buyers, Builders: Lawmakers to Consider Three Years of Tax Credits*, MODESTO BEE, Jan. 8, 2010 (on file with the *McGeorge Law Review*).

48. See Background Sheet, *supra* note 9 (“We believe recovery of California’s housing market is critically important to the state’s economic health.”).

49. Alejandro Lazo, *Signs Seen of a Housing Rebound in Southern California*, L.A. TIMES, Apr. 14, 2010, at Business 1 (on file with the *McGeorge Law Review*).

50. See *id.* (“The real question is how sustainable that recovery is The market is being driven by government policy . . . and now the government is starting to back off.”); Alejandro Lazo, *Southern California Housing Market Holds Its Ground*, L.A. TIMES, May 19, 2010, at Business 2 (on file with the *McGeorge Law Review*).

51. See Press Release, Cal. Ass’n of Realtors, C.A.R. Applauds Homebuyer Tax Credit Legislation (Mar. 25, 2010), <http://www.car.org/newsstand/newsreleases/2010newsreleases/ab183signature/> [hereinafter C.A.R. Press Release] (on file with the *McGeorge Law Review*) (praising Gov. Schwarzenegger for signing the bill and touting its positive economic impacts).

52. See Denis C. Theriault, *Gas Tax Deal Comes With Goodies for California Home Buyers and Green-Tech Manufacturers*, OAKLAND TRIB., Mar. 22, 2010, available at 2010 WLNR 6018491 (on file with the *McGeorge Law Review*) (statement of Assemblywoman Alyson Huber) (“As people buy these homes, they call the painter, they replace the carpet, they bring in the landscaper.”).

53. Press Release, Arnold Schwarzenegger, Cal. Governor, Governor Schwarzenegger Discusses Actions Taken to Create Jobs in California in Weekly Radio Address (Mar. 26, 2010), available at <http://gov.ca.gov/press-release/14723> (on file with the *McGeorge Law Review*).

first-time homebuyers will have a positive effect on existing neighborhoods by purchasing foreclosed and abandoned homes, which could ultimately raise property values.⁵⁴

B. A Financial Giveaway at the Cost of Vital Services

Skeptical of Chapter 12's effects, critics view it as a giveaway to banks and developers.⁵⁵ There is a big concern that the tax credit comes at the expense of other vital government services that are facing severe economic stress due to the state's budget deficit, and that the \$200 million price tag may force other services to make major cutbacks or be eliminated as a result.⁵⁶ State Senator Loni Hancock voted against Chapter 12 because she believes the "tax credit may force further cutbacks in education, job creation and rebuilding our crumbling roads and bridges."⁵⁷

Critics also argue that the credit does nothing to spur home sales because these homebuyers are planning to buy anyway.⁵⁸ The fact that April 2010 sales dropped in the Southern California region for the first time in twenty-two months suggests that the critics' assertion is true.⁵⁹ This drop may be attributed to the start of Chapter 12 on May 1, 2010, and the overlap of a similar federal homebuyer tax credit program, which means delaying the sale a couple of weeks allowed homebuyers to receive both state and federal tax credits.⁶⁰ Some builders are even touting the dual credit opportunity when marketing residential communities.⁶¹

54. Anna Caballero, Op-Ed., *Caballero: Economy Can Use More Homebuyers' Tax Credits*, MODESTO BEE, APR. 16, 2010, available at <http://www.modbee.com/2010/04/15/1129764/caballero-economy-can-use-more.html> (on file with the *McGeorge Law Review*).

55. See Kathleen Pender, *Some Home Buyers Get New State Tax Credit*, S.F. CHRON., Mar. 28, 2010, at D1 (statement of State Senator Loni Hancock) ("I am concerned that this tax credit helps developers and banks more than average Californians.").

56. See Editorial, *A Giveaway at the Worst Possible Time*, SACRAMENTO BEE, Mar. 25, 2010, at 16A (on file with the *McGeorge Law Review*) ("Such money could be used to maintain adult day care services or preserve farmland through the Williamson Act . . .").

57. Pender, *supra* note 55.

58. See Eric Wolff, *Housing: A Tax Credit Ends, Long Live the Tax Credit*, N. COUNTY TIMES, Apr. 30, 2010, available at http://www.nctimes.com/business/article_729d2300-e0e5-560b-a196-9c2f4ba0a400.html (on file with the *McGeorge Law Review*) ("Critics . . . have attacked the tax credit . . . because the home sales would have happened regardless.").

59. Lazo, *Southern California Housing Market Holds Its Ground*, *supra* note 50.

60. See Jim Wasserman, *Homebuyers Rush to Claim State Tax Credits*, SACRAMENTO BEE, May 18, 2010, at 6B (on file with the *McGeorge Law Review*) ("Some first-time buyers delayed scheduled April escrow closings until May . . . to snag both [state and federal credits].").

61. Press Release, Met Warner Ctr., *Now is the Time to Purchase as the Met Warner Center* (Apr. 14, 2010), available at <http://www.marketwire.com/press-release/Now-Is-the-Time-to-Purchase-at-The-Met-Warner-Center-1168539.htm> (on file with the *McGeorge Law Review*).

Supporters counter this argument with studies of their own, suggesting that nearly forty percent of homebuyers would not have purchased a home at all without the tax credit programs.⁶² Yet critics point out that since an oversupply of housing on the market caused the housing crisis, even if the credit spurs new job growth, it does so through building more housing which does not actually help the underlying problem.⁶³ Researchers, however, argue that ultimately the tax credit, in conjunction with low interest rates and low prices, is one of the “important factors working to heal the market.”⁶⁴

V. CONCLUSION

By 2009, the housing market showed a dramatic rebound from its fall in 2007 and 2008.⁶⁵ This rebound coincided with the tax credit programs offered by both California and the federal government, which indicates the tax credits’ likely influence on wavering buyers.⁶⁶ With the federal program coming to an end, Chapter 12 is likely to fill the void on a smaller scale.⁶⁷ The housing market remains shaky but is showing signs of stabilization.⁶⁸ And while tax credits like Chapter 12 are assisting in the stabilization effort for now, the housing market will eventually return to market-based fundamentals.⁶⁹ In the meantime, Chapter 12 provides some assistance to stimulate the economy in a positive direction.⁷⁰ It remains to be seen whether Chapter 12 will have a lasting impression or if it will be “like throwing a pebble in the ocean.”⁷¹

62. C.A.R. Press Release, *supra* note 51.

63. Editorial, *A Giveaway at the Worst Possible Time*, *supra* note 56.

64. Eve Mitchell, *State Tax Credit for Homebuyers Could Be Used Up in Three Weeks*, SAN JOSE MERCURY NEWS, May 7, 2010, at 1D (on file with the *McGeorge Law Review*).

65. Wasserman, *supra* note 7.

66. *See id.* (“The sales and pricing numbers paint a definitive picture of a 2009 market prodded by government stimulus and an abundance of bank repos in its earliest months.”).

67. *See* Alex Altman, *State’s Homebuyer Tax Credit Seeks to Spur New Home Purchases*, PUB. REC., Apr. 20, 2010, at 1, available at 2010 WLNR 9823191 (“The jury is still out, but the impact [of the state tax credit] is likely to be smaller . . .”).

68. *See* Eve Mitchell, *Prices Rise, Sales Dip*, CONTRA COSTA TIMES, May 21, 2010, at 1C (on file with the *McGeorge Law Review*) (pointing out the decrease in foreclosure sales and the increase in median home prices, while recognizing the potential effect of continued unemployment and any new round of new foreclosures hitting the market).

69. *See id.* (statement of John Walsh) (“The bigger picture is that the housing market will gradually be decoupled from government stimulus and be on its own again.”).

70. *See* Altman, *supra* note 67 (statement of Marie Keefe) (“The state [tax credit] program will help, . . . but it will be nowhere as big [as the federal program].”).

71. John Ellis, *Governor in Fresno, Backs Housing Tax Credit*, FRESNO BEE, Jan. 14, 2010, available at <http://www.fresnobee.com/2010/01/13/1779790/governor-in-fresno-backs-housing.html> (on file with the *McGeorge Law Review*).

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