

Legislative Analysis



CREATE THE MICHIGAN FIRST-TIME HOME BUYER SAVINGS PROGRAM

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Senate Bill 511 (reported from House committee w/o amendment)
Sponsor: Sen. Peter MacGregor

Analysis available at
<http://www.legislature.mi.gov>

Senate Bill 512 (reported from House committee as substitute H-1)
Sponsor: Sen. Ken Horn

House Committee: Tax Policy
Senate Committee: Finance
Complete to 5-4-18

BRIEF SUMMARY: Together, Senate Bills 511 and 512 would create the Michigan First-Time Home Buyer Savings Program. The program would allow individuals to create savings accounts with state income tax benefits for the purpose of using the funds for a down payment on a house. The bills are tie-barred together, which means that neither could take effect unless both were enacted.

FISCAL IMPACT: Determining the fiscal impact depends on the number of taxpayers who avail themselves of the program and the annual amount saved. (See *Fiscal Information*, below, for further discussion.)

THE APPARENT PROBLEM:

Homeownership is often seen as a key to the American Dream: it fosters community and civic engagement, leads to stability for youth in local schools, and promotes self-sufficiency. But for many, one challenge remains on the path to homeownership: the down payment. A down payment of 5% to 10% of the purchase price might now be seen as a ballpark estimate. While the exact mortgage terms and loan programs vary, saving around \$10,000 for the down payment on an average-priced \$140,000 home is difficult. Many believe that more can be done to support this type of saving. Legislation has been introduced to provide for savings accounts with state income tax benefits to be used for the down payment on a home in Michigan.

THE CONTENT OF THE BILLS:

Senate Bill 511 would create the Michigan First-Time Home Buyer Savings Program ("program") in the Department of Treasury ("department"). The purposes, powers, and duties of the program would be vested in and exercised by the state treasurer or his or her designee.

Under the bill, beginning January 1, 2018, any individual could open an account with a *financial institution* and designate the account, in its entirety, as a *first-time home buyer savings account* to be used to pay or reimburse a *qualified beneficiary's eligible costs* for the purchase of a *single-family residence* in Michigan.

Financial institution would mean any bank, trust company, savings institution, industrial loan association, consumer finance company, credit union, or any benefit

association, insurance company, safe deposit company, money market mutual fund, or similar entity authorized to do business in Michigan.

First-time home buyer savings account (“account”) would mean an account with a financial institution that an account holder designates as a first-time home buyer savings account status on his or her income tax return pursuant to the proposed act, for the purpose of paying or reimbursing eligible costs for the purchase of a single-family residence in Michigan by a qualified beneficiary.

Qualified beneficiary would mean a first-time home buyer who is designated as the beneficiary of an account designated by the account holder as a first-time home buyer savings account.

Eligible costs would mean the down payment and allowable closing costs for the purchase of a single-family residence in Michigan by a qualified beneficiary.

Single-family residence would mean a single-family residence owned and occupied by a qualified beneficiary as the qualified beneficiary’s principal residence, and would include a manufactured home, trailer, mobile home, condominium unit, or cooperative.

An *account holder* would have to designate a *first-time home buyer* as the qualified beneficiary for the account. The account holder could designate himself or herself as the qualified beneficiary, and could change the qualified beneficiary at any time, but there could not be more than 1 beneficiary at any time.

Account holder would mean an individual who establishes, individually or jointly with 1 or more other individuals, an account with a financial institution for which the account holder claims a first-time home buyer savings account status on his or her Michigan income tax return.

First-time home buyer would mean an individual who is a Michigan resident and has not owned or purchased, individually or jointly, a single-family residence during a period of 3 years prior to the date of the purchase of a single-family residence.

An individual could jointly own an account with another person if the joint account holders file a joint return under the Michigan income tax act. An individual could be the account holder of more than 1 account, but could not have multiple accounts with the same qualified beneficiary. An individual could be the beneficiary on more than 1 account.

Only cash and marketable securities could be contributed to an account, and anyone could contribute. The maximum account balance would be capped at \$50,000, but an account that had reached the maximum balance could continue to accrue earnings. Contributions to and interest earned on an account would be exempt from taxation, as would qualified withdrawals.

Qualified withdrawal would mean a withdrawal from an account that is not subject to a penalty under the proposed act or taxation under the Income Tax Act and that is either of the following: (1) a withdrawal from an account to pay the eligible costs of the qualified beneficiary incurred after the account is established; (2) a withdrawal made as the result of the death or disability of the qualified beneficiary of an account.

If funds were withdrawn from an account for any purpose other than the payment of eligible costs by or on behalf of a beneficiary, a 10% penalty, payable to the department, would be assessed on the amount withdrawn. The penalty would not apply if the funds were withdrawn for any of the following reasons: (1) withdrawn by reason of the beneficiary's death or disability, (2) a disbursement of assets of the account pursuant to a filing for protection under chapter 11 of the United States bankruptcy code, or (3) transferred from a home buyer savings account into another home buyer savings account.

The account holder would be responsible for the use or application of funds in the account. The account holder would not be able to use the funds in an account to pay expenses of administering the account, except that a service fee could be deducted from the account by the financial institution. An account holder could withdraw funds from an account and deposit the funds in a new account held by a different financial institution or the same financial institution.

An account holder would have to submit, with the account holder's state income tax return, all of the following to the department on forms prescribed by the department:

- Detailed information regarding the account, including a list of transactions during the tax year.
- The Form 1099 issued by the financial institution for the account.
- Upon withdrawal of funds, a detailed account of the eligible costs toward which the account funds were applied and a statement of the amount of funds remaining, if any.

The department would have to prepare the following forms to be filed with an individual's income tax return:

- The designation of an account with a financial institution to serve as a first-time home buyer savings account.
- The designation of a qualified beneficiary for the account.
- A form to annually submit to the department detailed information regarding the account, including a list of transactions for the account during the tax year, and identifying any supporting documentation that is required to be maintained by the account holder.

The state treasurer could promulgate rules to implement the program under the Administrative Procedures Act of 1969. The rules could not impose any obligations or requirements on financial institutions-related accounts for first-time home buyer savings accounts. The department could also prepare and distribute informational materials on the savings program to financial institutions and potential home buyers.

The financial institution would not be required to do any of the following:

- Designate an account as a home buyer savings account, or designate the qualified beneficiaries of an account, in the institution's contracts or systems.
- Track the use of money withdrawn from an account.
- Allocate funds in an account among joint account holders or multiple beneficiaries.
- Report any information to the department that is not otherwise required by law.

A financial institution would not be liable for any of the following:

- Determining that an account satisfies the requirements to be a first-time home buyer savings account.

- Determining that the funds in an account are used for eligible costs.
- Reporting or remitting taxes or penalties related to the use of an account.

If provided with the proof of death of the account holder and any other information required of the savings account contract, a financial institutional would have to distribute the principal and accumulated interest in the account in accordance with the terms of the contract.

Senate Bill 512 would amend the Income Tax Act to provide for the tax benefits of the accounts. The changes are as follows:

For tax years that begin after December 31, 2017, a taxpayer could deduct all of the following:

- To the extent not deducted in determining adjusted gross income (AGI), contributions made by the taxpayer in the tax year less qualified withdrawals made in the tax year from a first-time home buyer savings account, not to exceed a total deduction of \$5,000 for a single return or \$10,000 for a joint return per tax year. The amount calculated would have to be greater than zero, and a deduction could not be claimed for more than 20 tax years.
- To the extent not deducted in determining AGI, interest earned in the tax year on the contributions to the account, if the contributions were deductible.
- To the extent included in AGI, distributions that are qualified withdrawals from an account to the beneficiary of the account.

The taxpayer would have to add, subject to certain limitations and to the extent not included in AGI, the amount of money withdrawn by the taxpayer in the tax year from the account, not to exceed the deduction of contributions less qualified withdrawals, if the withdrawal was not a qualified withdrawal.

MCL 206.30

HOUSE COMMITTEE ACTION:

The House Committee on Tax Policy adopted and reported an H-1 substitute for Senate Bill 512. The H-1 substitute incorporates changes made to Section 30 of the Income Tax Act by Public Act 38 of 2018, which was signed into law on February 28, 2018. Absent this “conflict substitute,” the changes made to the law by Public Act 38 of 2018 would be effectively undone should Senate Bill 512 be enacted. The substitute makes no other changes to Senate Bill 512.

FISCAL INFORMATION:

In 2017, first-time home buyers accounted for about 34% of all home purchases at the national level, and the average down payment was 6% of the purchase price. The median home price for first-time purchasers was \$182,500, about 78% of the median price for all home purchases. Using this information to scale 2017 Michigan data, there would be about 45,500 first time purchasers, a median home price of \$141,150, and a down payment of about \$8,500.

Because it is likely that participants will save for more than just one year before making a purchase, the annual revenue loss will increase for two or three years as more prospective taxpayers take advantage of the annual exemption. At some point the number of new

participants will be balanced by first-time purchasers, and the revenue loss will grow more slowly primarily due to increases in home prices.

As previously stated, the participation rate and annual savings are the two most critical variables in estimating the fiscal impact, and deviations from the assumed amounts can alter the estimate significantly. An evaluation of TY 2016 income tax data shows that for a similar program designed to promote saving for higher education (the Michigan Educational Savings Program), there were roughly 63,400 participants and net income tax revenue was reduced by about \$10.5 million. Given that the MESP is intended as a longer term savings program for higher education expenses, it is reasonable to assume that the revenue loss resulting from a savings program to benefit first-time home buyers would be substantially less. If the average taxpayer participates for three years before purchasing a home and 25% of each year's first-time home buyers participate in the program, the revenue loss would stabilize at roughly \$4.0 million to \$5.0 million on an annual basis.

Because the exemption would likely result in higher refunds as opposed to lower payments, almost all of the impact would be borne by the General Fund.

ARGUMENTS:

For:

The savings account program proposed in the bills is an ideal vehicle to address the homeownership and down payment challenge in Michigan. The tax benefits—being able to deduct contributions and use qualified withdrawals tax-free—will incentivize individuals to save for down payments, even those who might think of homeownership as an unattainable goal. Survey data from supporters of the bills show that more people would like to buy a home than can afford to, and polling indicates that people support the savings account idea, with renters reporting that they would utilize the accounts.

For:

The savings account will not only help families save for and invest in homes, but helps the entire state invest in itself. The incentivized accounts will help keep people in Michigan, or even attract people to move here. The savings account must be used for a home purchase in Michigan; otherwise, the account holder faces a penalty.

Against:

It may be the case that those most likely to already save for a home—potentially higher income individuals with existing access to bank and savings accounts—will disproportionately utilize the program; low-income individuals may have less opportunity to access the program. In that sense, the state as a whole—including low-income individuals—will be shouldering the cost of the tax benefit for a few.

Response:

Promoting home ownership is a valuable and achievable state policy goal. Even if there are short-term costs to the tax benefit, the long-term gains—more home owners in Michigan, more stable families, more housing construction—will outweigh those costs.

Additionally, the program is structured so that anyone can access the account: there are no prequalifications or application requirements. In fact, one might expect that middle-income buyers would be most likely to use the savings account program: high-income buyers may

simply not need to save at all, and low-income individuals may qualify for other state and federal home ownership assistance programs.

Against:

The state should not rewrite the tax code to incentivize a specific activity that benefits a specific group of individuals. With an overhaul of the state income tax in the early 2010s, Michigan has worked to eliminate specific tax credits and incentives. While saving for a house is no doubt an admirable goal, there are many worthy purposes for saving. What about saving to start a new business? What about saving for medical costs? The state should not be in the business of picking various behaviors that will receive preferential tax treatment.

POSITIONS:

Individuals from the following entities testified in support of the bills:

Michigan Realtors (3-21-18; and indicated support 5-2-18)

Michigan Bankers Association (3-21-18)

Michigan Chamber of Commerce (3-21-18)

The Michigan Credit Union League indicated support for the bills. (5-2-18)

The Michigan Department of Treasury testified in opposition to the bills. (3-21-18; and indicated opposition 5-2-18)

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.