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BILL ANALYSIS

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Senate Bill 145 (as enacted) **PUBLIC ACT 6 of 2022**
House Bill 4290 (as enacted) **PUBLIC ACT 5 of 2022**
Sponsor: Senator Ken Horn (S.B. 145)
Representative Mari Manoogian (H.B. 4290)
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 4-6-22

CONTENT

Senate Bill 145 created the "Michigan First-Time Home Buyer Savings Program Act" to do the following:

- **Require the Department of Treasury to establish the First-Time Home Buyer Savings Program.**
- **Allow an individual, beginning January 1, 2022, through December 31, 2026, to open an account with a financial institution and designate the account as a first-time home buyer savings account to be used to pay or reimburse a beneficiary's eligible costs for the purchase of a single-family residence in the State.**
- **Specify that contributions to and interest earned on a first-time home buyer savings account, as well as qualified withdrawals made from the account, are exempt from taxation under the Income Tax Act.**
- **Limit the maximum account balance of a first-time home buyer savings account to $50,000, subject to an earnings exception.**
- **Specify that, subject to certain exceptions, funds withdrawn from an account for any purpose other than the payment of eligible costs are subject to a penalty equal to 10% of the amount withdrawn.**
- **Specify what a financial institution is not responsible or liable for with respect to first-time home buyer savings accounts.**
- **Require the Department to prescribe the form and manner in which a taxpayer must claim the deduction and require certain information to be included in the form.**
- **Allow the State Treasurer to promulgate rules to implement the Program.**
- **Allow the Department to prepare and distribute informational materials on the Program to financial institutions and potential home buyers.**

House Bill 4290 amended the Income Tax Act to allow, for tax years beginning on and after January 1, 2020, through the 2026 tax year, a deduction of up to $5,000 for a single return and $10,000 for a joint return for contributions to a first-time home buyer savings account. The bill also allows a deduction for interest earned on contributions and for distributions that are qualified withdrawals from the account.

Senate Bill 145

Definitions

"First-time home buyer" means an individual who is a resident of the State and has not owned or purchased, either individually or jointly, a single-family residence during a period of three years before the date of the purchase of a single-family residence. "Single-family residence" means a single-family residence owned and occupied by a qualified beneficiary as his or her principal residence (as that term is defined in the General Property Tax Act). The term includes a manufactured home, trailer, mobile home, condominium, or cooperative.

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

First-Time Home Buyer Savings Account

The First-Time Home Buyer Savings Program is established in the Department of Treasury. The purposes, powers, and duties of the Program are vested in and must be exercised by the State Treasurer or his or her designee.

Beginning January 1, 2022, through December 31, 2026, any individual may 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 the State. An account holder must designate a first-time home buyer as the qualified beneficiary of the account. The account holder may designate himself or herself as the qualified beneficiary and may change the designated qualified beneficiary at any time, but there may not be more than one qualified beneficiary at any one time.

An individual may jointly own a first-time home buyer savings account with another person if the joint account holders file a joint return under the Income Tax Act. An individual may be the account holder of more than one first-time home buyer savings account; however, an account holder may not have multiple accounts that designate the same qualified beneficiary. An individual may be designated as the qualified beneficiary on more than one first-time home buyer savings account.

Only cash and marketable securities may be contributed to a first-time home buyer savings account. Subject to the limitation on the amount of contributions, people other than the account holder may make contributions to a first-time home buyer savings account.

The account holder is responsible for the use or application of funds in a first-time home buyer savings account. The account holder may not use funds held in an account to pay expenses of administering the account, although a financial institution may deduct a service fee from the account. An account holder may withdraw funds, in whole or in part, from a first-time home buyer savings account and deposit them in a new first-time home buyer savings account held by a different financial institution or the same institution. If needed, an account holder or qualified beneficiary may make a hardship withdrawal from the account due to an immediate and heavy financial need of the account holder or qualified beneficiary. The amount must be limited to the amount necessary to satisfy the need. A hardship withdrawal is not a qualified withdrawal and is subject to the individual income tax.

The account balance for a first-time home buyer savings account may not exceed a maximum of $50,000. Accounts may continue to accrue earnings if the total balance has reached the limit and not be considered to have exceeded the maximum account balance.

Tax Exemption

Contributions to and interest earned on a first-time home buyer savings account, as well as qualified withdrawals made from the account, are exempt from taxation under Section 30 of the Income Tax Act (the section Senate Bill 146 amended). "Qualified withdrawal" means 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 a withdrawal from an account that is made at least one year after the account was opened and designated as a first-time home buyer savings account and the withdrawal is used to pay the eligible costs of the qualified beneficiary incurred at least one year after the account is designated.

Penalty

If funds are withdrawn from an account for any purpose other than the payment of eligible costs by or on behalf of a qualified beneficiary, there is a penalty equal to 10% of the amount withdrawn. The penalty must be paid to the Department. However, the penalty does not apply if the funds withdrawn satisfy any of the following:

-- Withdrawn by reason of the qualified beneficiary's death or disability.
-- A disbursement of assets of the account under a filing for protection under the United States Bankruptcy Code.
-- Transfer from an account established under the proposed Act into another account established under the Act for the benefit of another qualified beneficiary.
-- Withdrawn by reason of a hardship withdrawal.
-- Withdrawn by reason of a qualified beneficiary who is a service member who is transferred or deployed out of Michigan on active duty and provides proof acceptable to the Department that the qualified beneficiary or his or her spouse is assigned to a duty station outside of the State under a permanent change of station order.

Document Submission & Department Rules

An account holder must submit, with his or her income tax return, all of the following to the Department, along with the form prescribed by the Department:

-- Account statement that show the contributions made during the tax year and taxable interest or earnings on the account in the tax year for which the deduction is claimed.
-- Detailed information regarding the first-time home buyer savings account, including a list of transactions for the account during the tax year.
-- The Form 1099 issued by the financial institution for the account for the tax year the deduction is claimed.
-- After a withdrawal of funds from a first-time home buyer savings account, a copy of the real estate settlement statement that shows the withdrawal is used for eligible costs.

("Settlement statement" means the statement of receipts and disbursement for a transaction related to real estate, including a statement prescribed under the Real Estate Settlement Procedures Act or an executable sales agreement for the purchase of a manufactured home being conveyed as personal property.)

An account holder must maintain and keep, for a period of at least four years, suitable records and documentation, for each account, including account statements for all contributions and withdrawals made, a detailed list describing the transactions for the account, and other pertinent records and papers as required by the Department for the administration of the Act.

The Department must prescribe the form and manner in which a taxpayer must claim a deduction under the Act and Part 1 of the Income Tax Act on his or her individual income tax return. The form must include at least all of the following:

- -- The account holder's name.
- -- The name of the qualified beneficiary.
- -- The name of the financial institution and the account number.
- -- The beginning and end of the year balance of the account.
- -- The amount of the deduction claimed for the tax year.

The State Treasurer may promulgate rules to implement the Program. The rules may not apply to, or impose administrative, reporting, or other obligations or requirements on, financial institutions-related accounts for first-time home buyer savings accounts.

Financial Institutions

A financial institution does not have to do any of the following:

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

A financial institution is not responsible or liable for any of the following:

- -- Determining or ensuring that an account satisfies the requirements to be a first-time home buyer savings account.
- -- Determining or ensuring that funds in a first-time home buyer savings account are used for eligible costs.
- -- Reporting or remitting taxes or penalties related to the use of a first-time home buyer savings account.

After being furnished proof of the death of the account holder and any other information required by the contract governing the first-time home buyer savings account, a financial institution must distribute the principal and accumulated interest or other income in the account in accordance with the terms of the contract.

"Financial institution" means 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, broker, or similar entity authorized to do business in Michigan.

House Bill 4290

Under the Income Tax Act, for a person other than a corporation, estate, or trust, "taxable income" means adjusted gross income (AGI), as defined in the Internal Revenue Code, subject to various adjustments. For tax years beginning on and after January 1, 2022, the bill allows a taxpayer to deduct from taxable income all of the following:

- -- To the extent not deducted in determining AGI, contributions made by the taxpayer in the tax year less qualified withdrawals made in the tax year from a first-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; this deduction does not apply for tax years that begin after December 31, 2026.

-- To the extent not deducted in determining AGI, interest earned in the tax year on the contributions to the taxpayer's first-time home buyer savings account.
-- To the extent included in AGI, distributions that are qualified withdrawals from a first-time home buyer savings account to the qualified beneficiary of that account.

For tax years that begin on and after January 1, 2022, a taxpayer must add to his or her AGI, to the extent not included in AGI, the amount of money the taxpayer withdrew in the tax year from the first-time home buyer savings account, not to exceed the total amount deducted in the tax year and all previous tax years, if the withdrawal is not a qualified withdrawal. This provision does not apply to withdrawals that are less than the sum of all contributions made to a first-time home buyer savings account in all previous tax years for which no deduction is claimed, minus any contributions for which no deduction is claimed that are withdrawn in previous tax years

MCL 206.30 (H.B. 4290) Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bills will reduce revenue to both the State General Fund and the State School Aid Fund by approximately $1.9 million to $19.8 million per year between fiscal year (FY) 2021-22 and FY 2026-27, although the actual amount will depend on actual contributions and participation rates. Approximately 23.8% of any revenue reduction will lower School Aid Fund revenue, with the remaining impact lowering General Fund revenue. The maximum potential revenue loss under the bills may be much greater.

The most important variables in estimating the bills' fiscal impact are the participation rate and the average annual contribution to the accounts. The bills are more generous than similar proposals introduced or adopted in other states, suggesting that participation may be higher than estimated in other states. However, Michigan already has the fourth-highest homeownership rate in the United States, which may suggest that participation either is either greater (because homeownership is a higher priority with the population) or lower (because people, comparatively, are purchasing or owning homes at a higher rate already, suggesting that less assistance, like that the bills provide, is needed) than in programs in other states. Similarly, Michigan's marginal tax rate is approximately half to two-thirds of the tax rate in other states with similar proposals, meaning that the bills will provide relatively less tax relief than provided by the provisions in other states. A taxpayer claiming the maximum deduction under the bills will see his or her taxes lowered by $425, or 0.2% of the average home price in Michigan during 2020. The provisions will be on top of any Federal incentives for first-time homebuyers.

The temporary nature of the deduction, which is available only through tax years 2022 to 2026, also may reduce participation, especially for taxpayers that will require a longer period of time to save for a down payment. The short window for the deduction suggests that the majority of participants likely will be individuals who can afford, absent the bill, to make meaningful progress on saving for a down payment over a short period of time. Even if longer-term savers participate, the sunset on the deduction reduces the tax incentive to participate in the program. For example, if a taxpayer intends to save for 10 years toward a $20,000 down payment (roughly 10% of the average 2020 sale price) at $2,000 per year, the sunset will halve the tax incentive from the program.

Data from the Michigan Association of Realtors indicate that over the 2018-2020 period an average of 114,766 homes were sold each year. National figures indicate that first-time buyers represent 38% of purchasers. If contributions deductible under the bills average $5,500, and 8,000 individuals claim the deduction, the bills will reduce revenue by $1.9 million per year. In 2020, the average sale price totaled approximately $214,000. If 50% of the estimated number of first-time homebuyers save an average of five years to accumulate enough money in the account to make a 10% down payment on a mortgage for an average-priced home, the bill will reduce revenue by approximately $19.8 million per year by 2026; illustrating the degree to which the bills' fiscal impact may vary based on participation rates and average contributions.

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