

Legislative Analysis



MICHIGAN FIRST-TIME HOME BUYER SAVINGS PROGRAM

Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 4290 as enacted
Public Act 5 of 2022
Sponsor: Rep. Mari Manoogian

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

Senate Bill 145 as enacted
Public Act 6 of 2022
Sponsor: Sen. Kenneth Horn

House Committee: Tax Policy
Senate Committee: Finance
Complete to 7-22-22

BRIEF SUMMARY: House Bill 4290 and Senate Bill 145 together create the Michigan First-Time Home Buyer Savings Program, which allows individuals to create savings accounts with state income tax benefits for the purpose of making a down payment on a house.

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, there is a major challenge 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 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 145 creates a new act, the Michigan First-Time Home Buyer Savings Program Act, to establish the Michigan first-time home buyer savings program in the Department of Treasury. The purposes, powers, and duties of the program are vested in and exercised by the state treasurer or the state treasurer's designee.

First-time home buyer savings accounts

Under the act, through December 31, 2026, an 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 the **eligible costs** of a **qualified beneficiary** for the purchase of a **single-family residence** in Michigan.

Financial institution means a bank, trust company, savings institution, industrial loan association, consumer finance company, credit union, or a benefit association, insurance company, safe deposit company, money market mutual fund, broker, or similar entity authorized to do business in Michigan.

First-time home buyer savings account means an account with a financial institution that an account holder designates as a first-time home buyer savings account on the account holder's income tax return under the 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 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.

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

Single-family residence means a single-family residence owned and occupied by a qualified beneficiary as the qualified beneficiary's principal residence and includes a manufactured home, trailer, mobile home, condominium unit, or cooperative.

An **account holder** must designate a **first-time home buyer** as the qualified beneficiary for the account. Account holders may designate themselves as the qualified beneficiary, and may change the qualified beneficiary, but there cannot be more than one beneficiary at any one time.

Account holder means an individual who establishes, individually or jointly with one 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 their Michigan income tax return.

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

An individual may jointly own an 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 account, but cannot have multiple accounts with the same qualified beneficiary. An individual may be the beneficiary of more than one account.

Contributions and withdrawals

Only cash and marketable securities may be contributed to an account, and anyone can contribute. The maximum account balance is capped at \$50,000, but an account that has reached the maximum can continue to accrue earnings. Contributions to an account, interest earned on those contributions, and **qualified withdrawals** from the account are exempt from taxation, but the tax exemption for contributions does not apply on or after January 1, 2027.

Qualified withdrawal means a withdrawal from an account that meets all of the following:

- It is not subject to a penalty under the act.
- It is not subject to taxation under the Income Tax Act.
- It is made at least one year after the account was opened and designated as a first-time home buyer savings account.
- It is used to pay the eligible costs of the qualified beneficiary incurred at least one year after the account is designated.

If funds are 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 of Treasury is assessed on the amount withdrawn. The penalty does not apply if the withdrawn funds are any of the following:

- Withdrawn by reason of the beneficiary's death or disability.
- A disbursement of assets of the account pursuant to a filing for protection under chapter 11 of the United States Bankruptcy Code.
- Transferred from a home buyer savings account into another home buyer savings account.
- Withdrawn by reason of a hardship withdrawal as described below.
- Withdrawn because a qualified beneficiary who is a ***service member*** is transferred or deployed out of state on ***active duty***.

Service member means a member of the United States Armed Forces,¹ a reserve branch of the United States Armed Forces, or the Michigan National Guard.

Active duty means active duty pursuant to an executive order of the president, an act of Congress, or an order of the governor.

The account holder is responsible for the use or application of funds in the account. The account holder cannot use the funds in an account to pay expenses of administering the account, except that the financial institution may deduct a service fee from the account. An account holder may withdraw funds from an account and deposit them in a new account held by the same or a different financial institution.

If necessary, 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. However, the amount withdrawn must be limited to what is needed to meet that need. A hardship withdrawal is not a qualified withdrawal and is subject to taxation under Part 1 of the Income Tax Act.

Documentation, forms, and rules

An account holder must submit all of the following to the Department of Treasury with the account holder's state income tax return:

- Account statements that show the contributions during the tax year and the taxable interest or earnings on the account for the applicable tax year.

¹ The act says that "Armed Forces," as used in this provision, means that term as defined in section 2 of the Veteran Right to Employment Services Act. However, "Armed Forces" is not defined in that section or that act.

- The applicable Form 1099 issued by the financial institution for the account.
- Upon withdrawal of funds, a copy of the real estate settlement statement that shows that the withdrawal was used for eligible costs.

An account holder must maintain and keep suitable records for the account for at least four years, including at least account statements for all contributions and withdrawals made, a detailed list describing account transactions, and other records and papers as the Department of Treasury requires.

The Department of Treasury must prescribe the form and manner for claiming the income tax deduction in accordance with the act and the Income Tax Act. The form must include at least the names of the account holder, qualified beneficiary, and financial institution; the account number and beginning and ending balance; and the amount of the deduction claimed.

The state treasurer may promulgate rules to implement the program. The rules cannot impose any obligations or requirements on financial institution–related accounts for first-time home buyer savings accounts. The Department of Treasury also may prepare and distribute informational materials on the savings program to financial institutions and potential home buyers.

Financial institutions

The financial institution is not be required 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 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 of Treasury that is not otherwise required by law.

A financial institution is not 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 must distribute the principal and accumulated interest in the account in accordance with the terms of the contract.

MCL 565.1001 to 565.1013

House Bill 4290 amends Part 1 of the Income Tax Act (individual income tax provisions) to provide for the tax benefits of the first-time home buyer savings accounts as follows:

For tax years that begin on and after January 1, 2022, a taxpayer may **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 cannot be less than zero. However, this deduction would not apply for tax years beginning on or after January 1, 2027.

- To the extent not deducted in determining AGI, interest earned in the tax year on the contributions to the account.
- To the extent included in AGI, distributions that are qualified withdrawals from an account to the qualified beneficiary of the account.

The taxpayer must **add**, to the extent not included in AGI and subject to certain limitations, 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

The bills took effect February 9, 2022.

BACKGROUND:

The bills were reintroductions of Senate Bills 511 and 512 of the 2017-18 legislative session. Those bills were passed by the House and Senate but were vetoed by Governor Snyder on December 21, 2018. In his veto message, the governor indicated support for the goal but questioned the use of the tax code to incentivize taxpayer behavior.²

FISCAL INFORMATION:

In 2020, first-time home buyers accounted for about 31% 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 in 2019 was \$215,000, about 79% of the median price for all home purchases. Using this information to scale 2020 Michigan data, there would be about 35,500 first-time purchasers, a median home price of \$200,655, and a down payment of about \$12,000.

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 noted, 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 tax year 2020 income tax data shows that, for a similar program designed to promote saving for higher education (the Michigan Educational Savings Program), there were just under 70,000 participants and net income tax revenue was reduced by about \$13.0 million. Given that the MESP is intended as a longer term savings

² https://www.michigan.gov/documents/snyder/Senate_Bills_511-512_veto_letter_641856_7.pdf

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 20% of each year's first-time homebuyers participate in the program, the revenue loss would stabilize at about \$2.5 million on an annual basis, although the five-year sunset might limit participation and result in a smaller revenue loss. If the exemption reduces the taxpayer's burden such that it creates a larger refund, the revenue impact would fall entirely on the general fund. However, if the taxpayer's liability declines but remains greater than zero, about 23.8% of the revenue loss will be borne by the School Aid Fund, with the remainder coming from 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 do so, and polling indicates that people support the savings account idea, with renters reporting that they would utilize the accounts.

Already, families are able to support education through 529 plans. In a similar way, parents and grandparents would be able to set aside money gradually in a tax-advantaged home buyer savings program to help ease the strain of a single large investment.

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 state as a whole and individual communities benefit from people who have committed to homeownership in a particular area.

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.

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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.