SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 114 (as passed by the Senate)
Sponsor: Senator Nick Smith
Committee: Finance

Date Completed: 6-14-89

RATIONALE

It is generally acknowledged that the availability of decent, safe, affordable housing directly affects the stability of families, the growth and development of neighborhoods, and the economic vitality of communities throughout the State. It is also generally acknowledged that decent, safe, affordable housing is quickly becoming unavailable to larger and larger segments of the population. Various reasons have been given for the current shortage of acceptable housing, including: the reduced Federal role in housing policy and concurrent reductions in funding for housing projects; passage of Federal legislation that has removed many incentives to real estate developers to construct residential multifamily housing projects, particularly those designed for low-income tenants; increased land prices; increased construction costs; high interest rates; deteriorating public housing projects; and urban renewal programs gone awry. Some people feel, however, that the biggest obstacle to home ownership is that persons cannot generate the sizable down payments that are generally necessary to purchase a home. It has been pointed out that a very low percentage of persons in their 20s can gather the money they need for a home. It has been suggested that using tax deductions to encourage persons to save would provide a financial mechanism to increase home ownership.

CONTENT

The bill would amend the Income Tax Act to provide for the establishment of home purchase accounts and allow taxpayers a tax deduction for money deposited in such an account. The account would be a nontaxable source of funds that an "account holder" could use for the first-time purchase of a home, i.e., a house, condominium, or unit in a cooperative housing corporation. The term "account holder" would apply to an individual, or to spouses if they filed a joint State income tax return, who had not previously owned a home and for whose benefit a home purchase account was created.

Specifically, the bill would allow a taxpayer who was an account holder to deposit up to $5,000 plus interest in a home purchase account (or up to $10,000 plus interest if he or she filed a joint income tax return) and deduct that amount from his or her State income tax. If the account holder applied the money in the account to the first-time purchase of a home, neither the principal nor the interest in the account would be considered taxable income. At the time the money was withdrawn, the holder would be required to submit to the Commissioner of Revenue in the Department of Treasury satisfactory proof that the money would be used for the purchase of a home. If the holder failed to apply all the money to the purchase of a home within one year after the first withdrawal from the account, submit the requisite proof to the Commissioner, and use the home as his or her primary residence for at least two years, the total amount accumulated in the account minus any amount that qualified for an exemption under the bill would be considered income to the holder. If the holder complied with the "requisite proof" and "primary residence" requirements but did not apply all of the money toward the purchase of a home, the amount of money actually used to purchase the home would not be income and would not be subject to tax, interest or penalty.

If home purchase account money were required to be considered income, the taxpayer would have to pay interest on the tax on the income from the date of the initial deposit in the account until the tax was paid. The taxpayer would also have to pay a penalty equal to 10% of the amount of the income. The Commissioner, however, could waive the penalty if the taxpayer showed that the penalty would cause hardship or was unequitable.

The Commissioner and the Financial Institutions Bureau would be required to cooperate in the creation, supervision, and regulation of home purchase accounts. Further, the Commissioner would be responsible for promulgating rules to implement the bill.

A "home purchase account" would be an account created for the exclusive benefit of an account holder and would include money invested in tax exempt bonds, the principal and interest of which were used exclusively for the purchase of a home. Money in the account could not be invested in life insurance contracts or commingled with any other money of the account holder.

MCL 206.30 et al.

FISCAL IMPACT

Senate Bill 114 would lead to an indeterminate reduction in General Fund revenues. For each home purchase account established with the $10,000 maximum for a joint return, the initial direct income tax revenue loss to the State would equal $460. Using U.S. census data and SFA assumptions, in 1985 there were an estimated 70,000 first-time home buyers in Michigan. Assuming one-third of these home buyers set up a home purchase account with the maximum $10,000, the bill would lead to an estimated GF/GP revenue reduction of $9 million to $11 million the first year. Assuming that households added to their account each year at the same time that new accounts were established, the annual revenue loss would increase in future years.

ARGUMENTS

Supporting Argument

According to the Michigan State Housing Development Authority, the rate of home ownership in Michigan has been at its lowest rate in a decade. In the last six years home ownership among 25- to 29-year-olds, traditionally the first-time home buyer group, reportedly has decreased by 15%. The decrease can be attributed to the ever increasing home prices (with the average price of a home in Michigan now ranging from $80,000 - $90,000), more restrictive mortgage loans, underwriting criteria, and higher rents that make it difficult for families to save enough for the required down payment and closing costs for purchasing a home. In fact, a study in 1986 by the National Association of Realtors, Home Ownership: Key to the American Dream, found that the inability to make a down payment is the single biggest deterrent to home ownership. Ironically, some claim, the monthly costs of owning a home often would not be much more than monthly costs of renting comparable quarters, if only people could afford the initial investment in a house.

The bill would provide a much needed mechanism for first-time home buyers to obtain sufficient funds to finance down payments for homes. Home purchase accounts could be used to enable individuals, young couples, and families to accumulate funds in a tax-free savings account that they could use in the future for a down payment on their first home. By providing a means by which more people could afford to purchaser their own home, the bill would help alleviate the problems the State is experiencing in housing.

Supporting Argument

The problem of homelessness and the lack of safe, affordable housing are reaching the crisis-level in Michigan just when the Federal government is abdicating most of the responsibility for providing decent housing to the states. The solution to the housing dilemma proposed by the bill is an attempt to use a minimum amount of scarce public funds to generate a maximum amount of investment in the State's housing market.

Opposing Argument

The housing problem is reaching a critical stage and that is precisely why attempts to alleviate the situation cannot depend on such unreliable funding sources as tax-free savings accounts. If the State is serious about addressing the housing problem, it cannot rely solely on tax incentives to finance the solutions. Low-income persons or working poor who can manage a monthly house payment or qualify for a housing assistance program, but who cannot afford an initial down payment for a home because they don't have enough money to put any in savings, would not be helped by the bill. In fact, the bill could serve only those persons who already have incomes that are high enough to allow them to save, meaning that they would get a tax break while others who don't have the means to save got no relief.

Response: The bill is not designed to solve all the problems in the State regarding housing availability, only to address one of the problems. While on one hand persons have difficulty in saving enough for a down payment, on the other current Federal and State tax policies discourage saving because savings are taxed. The bill would simply alter that policy somewhat for first-time homeowners and instead encourage savings. The State has many other programs designed to address the problems of providing low-income housing, and while they may be inadequate to address all the needs, they are addressing some of the needs. Solving all the housing problems in the State goes way beyond the scope of what this bill attempts.

Legislative Analyst: G. Towne
Fiscal Analyst: N. Khouri

A8990\S114A