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FLOOD INSURANCE TAX CREDIT

House Bill 4561 (Substitute H-1)
First Analysis (6-17-97)

Sponsor: Rep. Bob Brown
Committee: Tax Policy

THE APPARENT PROBLEM:

Sometimes homeowners discover after they have purchased their homes that they are living in a floodplain and are required to buy flood insurance. This has become more common recently, reportedly, because stricter enforcement of federal flood insurance laws has made lending institutions more vigilant about requiring borrowers to purchase flood insurance. For example, some homeowners seeking a second mortgage or home equity loan might discover for the first time that they are obliged to purchase flood insurance. And, according to committee testimony, some lenders are going back through their books of business to find borrowers in floodplains who should have purchased flood insurance at the time they took out a mortgage. The National Flood Insurance Reform Act of 1994, according to information from the Federal Emergency Management Agency (FEMA), comprehensively revised federal flood insurance laws with the aim of increasing compliance with flood insurance requirements and participation in the National Flood Insurance Program (NFIP) in order to provide additional income to the flood insurance fund and to decrease the financial burden of flooding on the federal government, taxpayers, and flood victims. Among other things, the law contains civil monetary penalties against financial institutions that commit violations. Agencies that regulate lenders have been required to revise their flood insurance regulations.

Under NFIP, according to FEMA materials, the federal government makes flood insurance available to residents of communities that adopt and enforce floodplain management ordinances. These ordinances regulate new construction, among other things, and generally aim at eliminating or minimizing future flood damage. Flood insurance is required to get financing to buy, build, or improve a home or other building located in a special flood hazard area (i.e., the 100-year flood plain). These areas are designated on maps issued by FEMA. (Maps are sometimes changed.) Federally regulated lending institutions are required to determine if a structure to be financed is located in such an area and, if it is, to require flood insurance as a condition of a mortgage, home equity loan, home improvement loan, and other similar loans. The insurance is provided by the federal program, but 90 percent of the policies are serviced by private insurance companies (referred to as write-your-own companies) without risk to the company. The rates are set by the program, and participating companies receive a service fee. The average premium is said to be $300, but can be much higher. Rates are based on risk, size of loan, and whether a property owner knew he or she was in a flood plain when the property was purchased. Rates are said to be lower if the property owner did not know of the flood risk at the time of purchase. In Michigan, there are said to be between 20,000 and 25,000 flood insurance polices in force.

The unanticipated expense of flood insurance is burdensome to many Michigan homeowners, some of whom consider it a "hidden tax", and legislation has been introduced that would provide them some assistance.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to provide a credit equal to the amount paid for flood insurance on a homestead or $100, whichever was less, in cases where a homeowner was required to purchase flood insurance by a mortgage company after the purchase of a home was final, provided that either 1) the homeowner had not known at the time of purchase that the homestead was in a floodplain; or 2) the municipality in which the homestead was located began participation in the National Flood Insurance Program after the date on which the purchase of the homestead was final. The credit would not be refundable; if the amount of the credit exceeded the tax liability, the excess amount would not be refunded. The term "homestead" would refer to that term as defined in the General Property Tax Act. (See Background Information.) The credit would be available for the 1997 tax year and for each tax year thereafter.

MCL 206.266

BACKGROUND INFORMATION:

The term "homestead" in the General Property Tax Act means that portion of a dwelling unit that is subject to property taxes and is owned and occupied as a principal residence by an owner of the dwelling or unit. The term also includes unoccupied property classified as residential adjoining or contiguous to the dwelling. Also covered is any portion of a principal residence rented or leased to another person as long as the portion is less than half of the total square footage of living space; a life care facility; and property owned by a cooperative housing corporation and occupied as a principal residence by tenant stockholders.

Information on the federal flood insurance program is available at http://www.fema.gov/nfip (among other places) on the Internet.

FISCAL IMPLICATIONS:

The House Fiscal Agency has estimated that the bill will result in a revenue reduction of $1.5 million to $2.25 million per year. (Fiscal Note dated 4-10-97)

ARGUMENTS:

For:

Some Michigan homeowners discover after they have bought their homes -- sometimes long after -- that they are living in a floodplain and must purchase federal flood insurance. This can result in an additional burden of more than $500 per year (and sometimes much more). Some people consider this requirement a "hidden tax" forced on unsuspecting property owners to defray the cost of federal flood relief programs. Some of these people might not have purchased the property had they known of the extra costs. A small state tax credit would provide them with some relief from this burden. The bill proposes only to assist homeowners who did not know they were purchasing property in a floodplain or whose communities joined the federal flood program after the homes had been purchased. Furthermore, if companion legislation is adopted strengthening notification provisions for prospective home buyers (as found in House Bill 4794), the need for this tax credit will decrease over time.

Response:

It should be noted that this bill applies only to "homesteads" as that term is defined under the General Property Tax Act. The term is found there for purposes of providing exemptions from local school operating taxes (as a result of the passage of Proposal A in 1994). The bill, as a result, would not apply to qualified agricultural property, second homes, or to some rental property. Is this equitable?

Against:

It is indeed unfortunate that some homeowners out of the blue face an unanticipated additional living expense when they are belatedly informed that they are living in a floodplain and so must purchase flood insurance. It is not clear, however, why this particular misfortune should result in an income tax credit from the State of Michigan.

There are also administrative concerns: it appears the Department of Treasury would just have to take a homeowner's word for it that he or she had been unaware a home was in a floodplain. Audits would be required to confirm this. The Department of Treasury has also made the argument that the acknowledgment by homeowners on the tax form that they had not been notified their property was in a floodplain could make lending institutions liable for penalties.

POSITIONS:

The Department of Treasury is opposed to the bill. (6-11-97)

The Michigan Education Association is opposed to the bill. (6-11-97)

Analyst: C. Couch

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