

**INDIVIDUAL OR FAMILY
DEVELOPMENT ACCOUNT
PROGRAM ACT**

House Bill 5306 (Substitute H-4)
Sponsor: Rep. Lynne Martinez

House Bill 5307 (Substitute H-4)
Sponsor: Rep. Mark Schauer

House Bill 5308 (Substitute H-4)
Sponsor: Rep. Patricia Godchaux

First Analysis (3-4-98)
**Committee: Urban Policy and Economic
Development**

THE APPARENT PROBLEM:

As welfare reform legislation, intended to encourage welfare recipients to become more self-sufficient, sweeps the nation, many people have become increasingly concerned by the apparent lack of opportunities for people at the lower end of the economic spectrum. One of the main concerns raised as the nation prepares to "end welfare as we know it" is: how will realistic opportunities for advancement be provided to people with marginal incomes? It has been suggested that, instead of income maintenance, one of the best ways of offering opportunity to low-income people is to help them to accumulate assets. One way to do this is to allow low-income residents to maintain individual or family development accounts.

The national welfare reform act authorizes states to create community-based individual development account (IDA) programs with the Targeted Assistance for Needy Families (TANF) block grant funds, and to disregard all money saved by the poor in IDAs when determining eligibility for all means-tested government assistance. The act also provides that only earned income can be saved in IDAs; designates nonprofit, community-based organizations as custodians of IDA accounts; and permits IDAs to be used for education, home ownership, and business capitalization.

According to the National Governor's Association, by January 31, 1997, 10 states had set up IDAs (Alabama, Arizona, California, Missouri, New Hampshire, North Carolina, Oregon, South Carolina, Tennessee, and Virginia) and even more have done so since.

Supporters of IDAs note that accounts such as these shift the focus, both of policy makers and welfare recipients, from consumption to investment--from consumer spending to savings. The programs are designed to remove barriers to asset building, and to promote asset accumulation. Supporters also note that asset-based policy and incentives for the non-poor are a common occurrence in taxation policy, although less frequent in social welfare policy. For example, according to the IDA Evaluation Handbook, it is estimated the federal government spent over \$160 billion in 1995, primarily through tax expenditures, to support home equity and retirement pension accounts for the non-poor, alone.

Last December, the house passed a package of bills to allow the state and local governments to participate in IDAs, and to ensure that individuals who invested in their future would not be penalized by having their eligibility for other assistance programs curtailed. Legislation has been introduced to create an act to establish and regulate these accounts and to provide certain tax deductions for amounts contributed to such accounts.

THE CONTENT OF THE BILLS:

The bills would create the Individual or Family Development Account Program Act and provide tax deductions for amounts contributed to such accounts under the Income Tax Act and the Single Business Tax Act.

House Bill 5306 would create the Individual or Family Development Account Program Act. The bill would establish an individual or family account program within the Department of Treasury. In general, the program would allow eligible persons and families to establish limited tax-free accounts to save for education, first-time purchase of a home, or business capitalization.

Development accounts would be administered by a community development organization (any tax-exempt charitable organization under section 501(c)(3) of the Internal Revenue Code of 1986, that has been approved by the director of the treasury department or his or her designee). The department would be required to authorize such organizations to administer development accounts on a not-for-profit basis. These organizations would be required to do all of the following:

- *Establish and administer one or more reserve funds to provide matching funds for account holders pursuant to match agreements.

- *Develop and implement development account match agreements to be used with account holders that include at least: the purpose of the account, the schedule of deposits to be made by the account holder, and the proposed schedule of the amount of matching funds the account holder will need from the community development organization and the projected date when those funds would be provided.

- *Develop a process for including account holders in decision making regarding the investment of the money in their accounts.

- *Develop a partnership with all account holders with whom the organization had account match agreements to assist the holder to effectively use the funds available through the account and offer support services to maximize the opportunities provided by the account program.

In reviewing the qualifications of the community development organizations, the department would have to consider all of the following: the significance and quality of proposed auxiliary services; the relationship of the proposed services to the goals of the program; and the organization's not-for-profit status, fiscal accountability, ability to provide or raise money for matching contributions, and ability to establish and administer a reserve fund. The reserve fund would be a fund created by an approved community development organization to fund the costs incurred in administering the program and to provide matching funds for money contributed to a development account. No more than five percent of the money in the reserve funds established by the community

development organization could be used for administration of the program.

In order to be eligible to establish a development account, an individual or family would have to have a household income that was less than or equal to 185 percent of the federal poverty level under the most recent guidelines established by the U.S. Department of Health and Human Services for the individual or the size of the family depending upon the nature of the account. When setting up the account, the holder would have to name at least one beneficiary and could change beneficiaries at any time. If the holder died, the account would be transferred to the beneficiary. If the beneficiary were dead or otherwise unable to accept the transfer, the money would be transferred to the estate of the beneficiary.

An account holder, when establishing an account, would be required to enter into a matching funds agreement with a community development organization. The account holder would be required to declare the purpose for which the account was being established and the account could only be used without penalty for payment of those qualified expenses. Depending upon the purpose of the account, the holder could withdraw money for the following expenses without penalty:

- 1) Educational expenses involved in attending postsecondary education at a college, university, community college, or junior college described or established under the state constitution, an independent nonprofit college or university located in Michigan, a state licensed vocational or technical school, or a state licensed proprietary school. Educational expenses would include tuition and fees required for enrollment or attendance and costs of fees, books, supplies, and equipment needed for courses of instruction. An educational development account could only be used for the individual's educational expenses or to pay for the educational expenses of any family member 17 years old or older.

- 2) The first-time purchase of a primary residence by an individual account holder or any member or members of the family where the account is for the purchase of a primary residence.

- 3) Start-up capitalization of a business for the account holder or any member of the holder's family who was 18 years of age or older where the account was for capitalization of a business.

Up to \$2,500 per tax year could be deposited in a development account tax-free and account balances of up to \$5,000 would be exempt from taxes. A financial institution that maintained a development account would be required to see that the account earned, at least, the

market rate of interest. However, accumulated interest earned on the account would not be included in determining whether an account had exceeded these restrictions. If a particular contribution would cause the account balance to exceed these limitations, the financial institution that maintained the account would be required to return the deposit to the account holder.

Withdrawals from a development account would require two signatures; the signature of the account holder and the signature of an administrator of the community development organization with which the account holder has a match agreement. Match agreement distributions from a community development organization would be made at the same time as the account holder's withdrawal of money to pay for qualified expenses. These distributions would be made by check payable to the account holder and the entity that the account holder is paying.

The first time that an account holder withdrew money from a development account for something other than a qualified expense, he or she would be required to pay a penalty of 10 percent of the amount withdrawn, and the amount withdrawn would be added to the holder's taxable income for the year of the withdrawal. If the account holder withdrew money for an unapproved purpose for a second time, he or she would pay a 10 percent penalty on the money withdrawn, and the amount withdrawn and all the money remaining in the account after the withdrawal would be added to his or her taxable income for that tax year and no money deposited into the account after that date would be exempt from taxation. The penalties charged would be taken, where possible, from money in the account and would be deposited in the community development account reserve fund of the community development organization with which the account holder had an account match agreement.

At the end of each tax year, the community development organization would be required to provide the account holder with a letter on the organization's letterhead that stated the total amount -- based upon deposits, withdrawals, add backs, and any disallowed deposits made in the tax year -- that the account holder could claim as a deduction on his or her income taxes. In order to facilitate this, each account holder would be required to provide copies of all bank statements issued regarding his or her account to the community development organization with which he or she had a match agreement.

Money deposited or withdrawn from a development account for qualified expenses and interest earned on a development account would be exempt from taxation

under the Income Tax Act. Furthermore, businesses and individuals could contribute to the reserve fund of a community development organization and deduct amounts equal to the contributions made against either their income tax or the single business tax, as appropriate. Each tax year, each community development organization that administered one or more reserve funds, with the cooperation of the participating financial institutions, would be required to submit the names of contributors to an individual or family development account reserve fund and the total amount that each had contributed that year to the Department of Treasury. The director of the department would determine the date by which the information would have to be submitted.

House Bill 5307 would amend the Income Tax Act of 1967 (MCL 206.30) to allow interest earned and amounts contributed during the tax year to an individual or family development account to be deducted from taxable income. However, deposits made after the account holder had made a second improper withdrawal would be taxable. Furthermore, the amount of the deduction could not exceed the contribution limits established in the Individual or Family Development Account Program Act. Amounts that had been withdrawn from the account for purposes other than the payment of authorized expenses would have to be subtracted from the amount of the deduction.

The bill would also provide that a non-account holder who contributed to the reserve fund of a community development organization under the Individual or Family Development Account Program Act could deduct the amount contributed from his or her taxable income.

In addition, the bill would include language clarifying the deduction allowance established under the Child Care Act of 1997. (The bill would repeal the section of the Income Tax Act that contains the child care deduction, and insert the same language into Section 30 of the act, which lists adjustments to taxable income.)

House Bill 5308 would amend the Single Business Tax Act (MCL 208.9) to add a deduction provision to allow a business to deduct the amount contributed in that tax year to the reserve fund of a community development organization under the provisions of the Individual or Family Development Account Program Act. The bill's provisions would apply to tax years that begin after December 31, 1997, and would limit the deduction to the amount included in the business' federal taxable income.

Tie-bars, effective date. None of the bills would take effect if the others were not also enacted. If enacted, House Bills 5306 and 5307 would take effect on January 1, 1998.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the package of bills would reduce state revenue by \$5 to \$10 million. (3-4-98)

them to compete with new businesses that would have the

ARGUMENTS:**For:**

As noted in the National Governor's Association Issue Brief entitled "Building Assets and Economic Independence Through Individual Development Accounts", owning assets gives people a stake in the future--a reason to save, to dream, and to invest time, effort, and resources in creating a future for themselves and their children. People move forward economically through savings and investment, not through spending and consumption. As a noted proponent of IDAs has said: Income may feed people's stomachs, but assets change their heads. Helping former and potential welfare recipients to re-think their circumstances, to plan for a future, and to imagine themselves moving from dependency to self-sufficiency, is a laudable goal.

For:

One of the obvious facts noted by many is that poorer people have few, or no, investable assets. According to the National Governor's Association, the distribution of assets in the United States is even more unequal than the distribution of income. Although the top 10 percent of Americans commands 40 percent of the national income, the top 1 percent controls as many assets as the bottom 80 percent. Unfortunately, asset deficiency usually places home ownership, entrepreneurship, and higher education out of the reach of many Americans and, in doing so, prevents them from advancing economically. Individual development accounts are potentially a key element in an assets-based strategy to break the cycle of poverty. The strategy is based on the notion that families need to accumulate a reasonable amount of cash assets to become self-sufficient and minimize the likelihood of returning to the public assistance rolls.

Against:

Two of the three purposes that would be allowed for the creation of individual development accounts are for acceptable purposes: education beyond high school; and, first-time home ownership. These are examples of investment and savings that the State of Michigan should endorse, and where possible, promote with incentives. However, the third qualified purpose would allow the poor to establish a savings account that would be used only to start a business. This bill would put existing businesses at a great disadvantage. It would require

advantage of tax-free capitalization. Further, businesses could be discouraged from contributing to these accounts if it were possible that the money they donated could be used against them to create a competing business that would have to compete on a level playing field.

Response:

Many impoverished regions, whether urban or rural, have too little investment and too few small businesses, rather than too many. As a result, there is little to no price competition for necessary goods and services. The lack of price competition often means that consumers in regions with little investment pay too dearly.

Against:

The bills could lower state revenue by allowing deductions from state income and single-business taxes. Early versions of the bills were estimated to cost the state about \$8.4 million in lost revenue.

POSITIONS:

The Center for Empowerment and Economic Development supports the bills. (3-3-98)

The Michigan Federation of Private Child and Family Agencies supports the bills. (3-3-98)

The Michigan Bankers Association supports the bills. (3-3-98)

Grand Rapids Opportunities for Women supports the concept of the bills. (3-3-98)

The Department of Treasury opposes the bills. (3-3-98)

The National Federation of Independent Business opposes the bills. (3-3-98)

Analyst: W. Flory
