House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

DEVELOPMENT ACCOUNTS

House Bill 4268
Sponsor: Rep. Lynne Martinez
Committee: Employment Relations, Training and Safety

House Bill 4265
Sponsor: Rep. Patricia Godchaux
Committee: Tax Policy

House Bill 4266
Sponsor: Rep. Mark Schauer
Committee: Tax Policy

Complete to 2-10-00

A SUMMARY OF HOUSE BILLS 4265, 4266, AND 4268 AS INTRODUCED 2-11-99

House Bill 4268 would create the Individual or Family Development Account Program Act, under which, generally speaking, eligible persons and families could establish limited tax-free savings accounts to pay for education, the first-time purchase of a home, or business capitalization. The accounts would be administered by non-profit community development organizations. These organizations would also establish reserve funds in order to provide matching funds to account holders and to accept matching contributions from outside sources. The newly created program would be housed within the Department of Treasury, which would have to approve the participation of community development organizations.

House Bill 4265 would amend the Single Business Tax Act (MCL 208.9) to allow a firm to deduct from its tax base contributions to the reserve fund of a community development organization administering such accounts. House Bill 4266 would amend the Income Tax Act (MCL 206.30) to exempt from the state income tax contributions a person made to his or her individual or family development account and interest earned in the account, and to exempt contributions to a reserve fund made by another party. Funds withdrawn from the account would also be exempt if used for the appropriate purposes.

House Bill 4268 contains the following provisions regarding the individual and family development account program.

Eligible Participants. In order to be eligible to establish a development account, an individual or family would have to have a household income at or below 185 percent of the federal poverty level under the most recent guidelines established by the U.S. Department of Health and Human Services. 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.

Account Limits. The maximum total of all deposits made into a development account in one year exempt from taxation would be $2,500. The total maximum balance in such an account would be $5,000. Accumulated interest earned on an account would not be included in this total. Deposits to the account that would cause the account to exceed the maximums would have to be returned to the account holder. The account could be with a bank, savings and loan association, trust company, or credit union. The accounts would have to earn at least the market rate of interest.

Match Agreements. 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. Community development organizations would be required to develop match agreements that included 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 would need from the community development organization and the projected date when those funds would be provided.

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. Match agreement distributions could not exceed a ratio of $5 to every $1 of the account holder's money and would be made by check payable to the account holder and the entity that the account holder was paying.

Community Development Organizations. Development accounts would be administered by community development organizations. Generally, a community development organization could be any tax-exempt charitable organization under section 501(c)(3) of the Internal Revenue Code of 1986 that had been approved by the director of the Department of Treasury or his or her designee. However, for the administration of a family or individual development account intended to save for start-up capitalization for a business, a community development organization would mean a "microenterprise loan fund" or a "microenterprise development organization." Community development 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 under match agreements; develop and implement development account match agreements; develop a process for including account holders in decision making regarding the investment of the money in their accounts; and develop a partnership with each account holder to help him or her to effectively use the funds available through the account and to offer support services to maximize the opportunities provided by the account program.

In reviewing the qualifications of the community development organizations, the Department of Treasury 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.

Permitted Fund Withdrawals. 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.

In addition, money could be withdrawn, without penalty, from an account to pay for medical expenses of the account holder or a member of his or her family that was not covered under any health benefit plan, or to pay an amount needed to prevent the account holder from being evicted from his or her home.

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.

Non-eligible Withdrawals. If an account holder withdrew money from a development account for something other than the qualified expense, a medical expense, or to prevent eviction, 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, the amount withdrawn would be taxable, and the account would lose its tax-exempt status. (That is, all the money remaining in the account after the withdrawal would be added to the account holder's 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.

Tax Exemption. 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.

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.

Tie-bars, effective date. None of the bills would take effect if the others were not also enacted. House Bills 4268 and 4266 each contains an effective date of January 1, 1999.

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.