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BILL ANALYSIS

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Senate Bill 640 (Substitute S-1 as passed by the Senate)  
Senate Bill 641 (Substitute S-1 as passed by the Senate)  
Senate Bill 642 (Substitute S-1 as passed by the Senate)  
Sponsor: Senator Buzz Thomas (S.B. 640 & 641)  
Senator Bill Hardiman (S.B. 642)  
Committee: Banking and Financial Institutions

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### **RATIONALE**

Some people believe that low-income people should have an opportunity to use the type of "individual development accounts" that are available to public assistance recipients under State and Federal law. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, sometimes called the national welfare reform act, authorizes states to create community-based individual development account (IDA) programs with Temporary Assistance for Needy Families (TANF) block grant funds. Individual development accounts are dedicated savings accounts that may be drawn upon to purchase a home, finance a postsecondary education, or start up a business. Accounts are managed by community organizations and held at local financial institutions. The community organizations, or "program sites" as they are known in IDA programs, also may offer personal financial management and home ownership classes. Money from public and private sources (such as TANF funds and grants from foundations) typically is used to provide a match to the savings of low-income participants in IDAs, providing an incentive for account holders to add to their savings.

In Michigan, Public Act 361 of 1998 amended the Social Welfare Act to require the Family Independence Agency, now called the Department of Human Services (DHS), to implement a program allowing an individual eligible for family independence assistance to establish an IDA for the purchase of a first home. Public Act 445 of 2004 amended the Social Welfare Act to

allow IDA savings also to be used for postsecondary education and business capitalization.

Some people believe that use of IDAs to save for educational expenses, a first-time home purchase, or business capitalization should be available to low-income earners, as well as to those eligible for assistance. To that end, it has been suggested that the law should extend that opportunity to anyone whose income is 200% of the Federal poverty level or less, and offer a tax credit to individuals or businesses that contribute to reserve funds that provide matching dollars to the deposits made by IDA holders.

### **CONTENT**

**Senate Bill 640 (S-1) would create the "Individual or Family Development Account Program Act", and Senate Bills 641 (S-1) and 642 (S-1) would amend the Single Business Tax Act and the Income Tax Act, respectively, to do all of the following:**

- **Establish the Individual or Family Development Account Program within the Michigan State Housing Development Authority (MSHDA).**
- **Require MSHDA to select program sites to administer the individual or family development accounts, and fiduciary organizations to provide technical assistance to program sites**

and establish and manage reserve accounts.

- **Specify criteria for MSHDA to consider in reviewing the qualifications of program sites and fiduciary organizations.**
- **Allow an individual or family whose income was 200% of the Federal poverty level or less to establish a development account.**
- **Allow an account to be established only for the qualified expenses of paying for: 1) educational expenses of an account holder who was at least 17 years old; 2) the first-time purchase of a primary residence; or 3) start-up capitalization of a business for an account holder who was at least 18.**
- **Require a program site to enter into a participant savings plan agreement with each account holder, and provide matching funds for an account holder's contributions to the account.**
- **Require fiduciary organizations to file annual reports with MSHDA, and MSHDA to file an annual report with the Legislature.**
- **Allow a qualified financial institution or taxpayer to claim an SBT credit equal to 75% of contributions made to a fiduciary organization's reserve fund.**
- **Allow a taxpayer who was not an account holder to claim a nonrefundable income tax credit equal to 75% of contributions made to a reserve fund.**
- **Specify that the SBT and income tax credits could not exceed an annual cumulative total of \$1.0 million.**

"Program site" would mean a charitable organization exempt from taxation under Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code (IRC) that is approved by the MSHDA Director, or the Director's designee, to implement the Individual or Family Development Account Program. "Fiduciary organization" would mean a charitable organization exempt from taxation under Section 501(c)(3) of the IRC that is approved by the MSHDA Director, or the Director's designee, to manage a reserve fund. A fiduciary organization also could be a program site. "Reserve fund" would mean an account established and managed by a fiduciary organization housed

at a financial institution. A reserve fund would hold money to be used to match participant savings based on a participant savings plan agreement.

Senate Bill 640 (S-1) would take effect on January 1, 2007. Senate Bills 641 (S-1) and 642 (S-1) are tie-barred to Senate Bill 640.

### **Senate Bill 640 (S-1)**

#### Development Account Program

The bill would establish the Individual or Family Development Account Program within MSHDA. The program would have to provide eligible individual and families with an opportunity to establish accounts to be used for education, first-time purchase of a primary residence, or business capitalization. The bill would require MSHDA to establish policies and procedures for the program, based on the policies and procedures adopted by the DHS to implement the Individual Development Account Program under Section 57k of the Social Welfare Act (MCL 400.57k).

The bill would require MSHDA to select both of the following:

- Program sites to administer the individual or family development accounts on a not-for-profit basis.
- Fiduciary organizations to provide technical assistance and support to program sites and establish and manage reserve accounts on a not-for-profit basis.

In reviewing the qualifications of fiduciary organizations and program sites, MSHDA would have to consider all of the following factors:

- The organization's not-for-profit status.
- The organization's fiscal accountability.
- The organization's ability to provide or raise money for matching contributions.
- The significance and quality of proposed auxiliary services to support the Program's goals.
- The availability of a financial literacy program for account holders.
- The ability to maintain and manage necessary program data for tracking account holders and participants in the Program and for development of reports required under the bill.

In reviewing the qualifications of fiduciary organizations, MSHDA also would have to consider an organization's ability to do all of the following:

- Administer one or more reserve funds to provide matching funds for account holders pursuant to participant savings plan agreements.
- Administer any money appropriated by the State for the purposes of the proposed Act.
- Collaborate with program sites on a regional basis.
- Provide technical assistance and support to program sites to assist them in administering programs effectively.
- Work in conjunction with approved program sites to hold, manage, and disburse match funds for accounts as provided in the bill.
- Maintain and manage necessary program data for tracking account holders and participants in the Program and for development reports required under the bill.

In reviewing the qualifications of program sites, MSHDA would have to consider the ability of a program site to develop and implement participant savings plan agreements to be used with account holders, that included at least all of the following:

- The purpose for which the account was established.
- The schedule of deposits that the account holder would make to the account.
- The agreed-upon amount of matching funds and the projected date when the funds would be provided.
- A plan to provide financial literacy; homeownership training; education, career, or business planning assistance, if appropriate; and any other services designed to increase the independence of the account holder, or his or her family, through the achievement of the designated purpose of the account.

In its review of program sites, MSHDA also would have to consider the ability of a program site to develop a partnership with all account holders with whom the program site had a participant savings plan agreement to assist the account holders effectively to make financial decisions relating to the use of the funds available through the accounts, and to offer support

services to maximize the opportunities provided by the Program.

The Authority could promulgate rules as needed to implement the proposed Act.

#### Individual or Family Development Accounts

An individual or family whose household income was less than or equal to 200% of the Federal poverty level could apply to a program site to establish an individual or family development account. A program site could approve applications to the extent that it had match funds available to meet match commitments in participant savings plan agreements.

A program site could reject an application if approving it would result in the establishment of an account by one or more members of a family that had established an account for the same person for the same purpose. A household could not have more than one account for the same purpose if that purpose were a first-time purchase of a primary residence or start-up capitalization of a business.

If a program site approved an individual's or family's application to establish an account, the individual would have to do all of the following:

- Establish the individual or family development account with a financial institution.
- Enter into a participant savings plan agreement with the program site.
- Declare, with the program site's approval, the purpose for which the account was established.
- Meet any other criteria the program site required.

An account could be established only to pay qualified expenses. An account would have to be established for one or more of the following purposes:

- To pay educational expenses for the individual account holder who would be 17 or older when the funds in the account would be used, if the account were for educational purposes.
- For the first-time purchase of a primary residence by the individual account holder, if the account were for the purchase of a primary residence.

-- For start-up capitalization of a business for the individual account holder who was at least 18, if the account were for capitalization of a business based on a business plan approved by the program site.

An account would have to require two signatures for withdrawals. The two signatures would have to be those of the account holder and an administrator of the program site with which the account holder had a participant savings plan agreement.

"Educational expenses" would mean tuition and fees required for the enrollment or attendance of a student at an eligible educational institution, and expenses for fees, books, supplies, and equipment required for courses of instruction at an eligible educational institution. "Eligible educational institution" would mean a State university; a public community or junior college; an independent nonprofit college or university located in Michigan; a State-licensed vocational or technical education program; or a State-licensed proprietary school.

#### Participant Savings Plan Agreements

A program site would have to enter into a participant savings plan agreement with each account holder who was approved to establish an individual or family development account. The program site would have to provide matching funds for contributions to the account by the account holder pursuant to the agreement.

Matching fund distributions would have to be made on behalf of an account holder pursuant to a participant savings plan agreement at the same time that the account holder withdrew money to pay qualified expenses. Matching distributions would have to be at least a match of every \$1 for every \$1 withdrawn from an account by an account holder to pay qualified expenses or for a purpose approved by MSHDA. Matching distributions would have to be made by check to the order of the account holder and the entity he or she was paying.

Money withdrawn during a calendar year from an individual or family development account by an account holder for a qualified expense would have to be matched by the

program site as provided in the participant savings plan agreement between the account holder and the program site.

#### Tax Credits

An entity could claim an SBT credit under Section 36e of the SBT Act (which Senate Bill 641 (S-1) would add), and an individual who was not an account holder and who was subject to the State income tax could claim a credit under Section 272 of the Income Tax Act (which Senate Bill 642 (S-1) would add), equal to 75% of contributions made to the reserve fund of a fiduciary organization. The total of all credits under Section 36e of the SBT Act and Section 272 of the Income Tax Act could not exceed \$1.0 million per calendar year.

The administrator of a fiduciary organization that administered one or more reserve funds, with the cooperation of the participating financial institutions, would have to submit to MSHDA the names of contributors and the total amount that each contributed to an individual or family development account reserve fund for each calendar year. The MSHDA director would have to determine the date by which the information would have to be submitted.

A taxpayer who made a contribution to a reserve fund would have to apply to MSHDA for certification that the contribution qualified for a credit. An application would have to be approved or denied within 45 days after it was received. If the application were not approved or denied within that time, it would be considered approved and MSHDA would have to issue a certificate stating that the taxpayer was eligible to claim a credit based on the contribution and the amount of the credit. If an application were denied, a taxpayer would not be prohibited from subsequently applying for another contribution.

In reviewing tax credit applications, MSHDA would have to consider all of the following criteria:

- The funds available to match contributions were deposited into a reserve fund in the same year that the credit would be claimed.
- The approval of the credit would not exceed the annual \$1 million cap for all credits.

- The overall benefit to the Program of the contribution for which a credit was requested.

A taxpayer could not claim a credit in excess of the amount approved by MSHDA. A taxpayer could not claim both an SBT and an income tax credit for the same contribution. A taxpayer would have to attach the tax credit certificate received from MSHDA to the SBT or income tax return on which a credit was claimed.

#### Annual Reports

A fiduciary organization selected to administer an individual or family development account program would have to file with MSHDA an annual report of the organization's individual development account program activity. The report would have to be filed by September 30 each year, and include at least all of the following:

- The number of individual development accounts administered by the fiduciary organization.
- The amount of deposits and matching deposits for each account.
- The purpose of each account.
- The number of withdrawals made.
- The number of terminated accounts and the reasons for termination.
- Any other information MSHDA required for the purpose of making a return-on-investment analysis.

By December 31 each year, MSHDA would have to file with the Secretary of the Senate and the Clerk of the House of Representatives a report that included all of the information in the fiduciary organization reports described above and copies of any changes in policies or procedures used to administer the proposed Act that occurred during the year.

#### Other Provisions

Contingent Beneficiary. An account holder would have to name at least one contingent beneficiary at the time the account was established and could change beneficiaries at any time. If an account holder died, the account would have to be transferred to a contingent beneficiary. If the named beneficiary were deceased or otherwise could not accept the transfer, the money

would have to be transferred to the beneficiary's estate.

Withdrawal Verification. A financial institution would not be responsible for verifying whether withdrawals from accounts held at the financial institution were made in accordance with and for a purpose allowed under the proposed Act.

#### **Senate Bill 641 (S-1)**

Under the bill, for tax years beginning after December 31, 2006, a qualified financial institution or taxpayer could claim an SBT credit equal to 75% of the contributions made in the tax year by that institution or taxpayer to the reserve fund of a fiduciary organization pursuant to the proposed Individual or Family Development Account Program Act.

If the credit and any unused carryforward of the credit exceeded the institution's or taxpayer's tax liability for the tax year, the excess could not be refunded, but could be carried forward as an offset to tax liability in subsequent tax years for 10 tax years or until the excess credit was used up, whichever occurred first.

The credits under the bill and Senate Bill 642 (S-1) could not exceed an annual cumulative maximum amount of \$1.0 million. The determination of the maximum allowed would have to be made as provided in the proposed Act.

#### **Senate Bill 642 (S-1)**

Under the bill, for tax years beginning after December 31, 2006, a taxpayer who was not an account holder under the proposed Individual or Family Development Account Program Act could claim an income tax credit equal to 75% of the contributions the taxpayer made in the tax year to the reserve fund of a fiduciary organization pursuant to the proposed Act.

If the amount of the income tax credit exceeded the taxpayer's tax liability for the tax year, the excess portion could not be refunded.

The credits under the bill and Senate Bill 641 (S-1) could not exceed an annual cumulative maximum amount of \$1.0 million. The determination of the maximum

allowed would have to be made as provided in the proposed Act.

Proposed MCL 208.36e (S.B. 641)  
Proposed MCL 206.272 (S.B. 642)

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

Individual development accounts would be an innovative tool to help low-income earners save toward home ownership, educational advancement, or starting a small business. The provision of matching funds to the amounts saved by the account holders would give IDA-eligible participants incentive to set aside some money. While the Social Welfare Act includes an IDA program for people receiving public assistance, the bills would help more people to save for the purchase of a first home, a college degree or vocational education, or small business capitalization. By implementing an IDA program for low-income earners, regardless of whether they received family independence assistance through the DHS, Senate Bill 640 (S-1) would extend to these individuals opportunities that may not otherwise be available to them.

**Response:** The bill would establish a new IDA program under MSHDA, while one already exists within the DHS. It is unclear whether the proposed program would replace the existing one, or whether the two similar programs would operate on an essentially parallel basis. Rather than create a new IDA program, perhaps the legislation should simply expand the existing one.

### **Supporting Argument**

The State's current IDA program for assistance recipients has seen steady growth in open accounts and asset investment. According to written testimony provided to the Senate Banking and Financial Institutions Committee by the Michigan IDA Partnership, a joint operation of the DHS and the Council of Michigan Foundations, as of May 2006, there were five IDA program Regional Networks and 50 IDA program sites in Michigan. Since 2001, there have been more than 1,400 open/active account holders saving toward their IDA asset goal and, as of May 17, 2006, 796 IDA

participants had made an asset investment. A woman from Jackson County testified before the Senate Committee that she saved \$20 a month in an IDA for three years and in 2005 was able to use the savings and the matching funds for a down payment on a home purchase. She now works as the coordinator for that IDA program site and told the Committee that one of her clients went from homelessness to home ownership in just two years. The success of this limited program suggests that a more widely available IDA program could greatly help Michigan's working families to save and invest in their futures, build financial security through ownership of assets, actively participate in the community, and contribute to the economy.

### **Supporting Argument**

By granting 75% tax credits for contributing to a reserve fund, Senate Bills 641 (S-1) and 642 (S-1) would create an incentive for taxpayers who did not hold an IDA to donate to a reserve fund that would provide matching funds for IDA holders' deposits. The tax credits would encourage taxpayers to invest in Michigan's people and help to ensure that sufficient matching funds were available to supplement the savings of IDA holders, thereby increasing their opportunities to further their education, develop new business concepts, and invest in home ownership.

**Response:** Capping the total tax credits at \$1.0 million would limit the money available for reserve funds to match IDA savings. In addition, since one or a few taxpayers conceivably could contribute enough money to claim the entire amount of the available credits, the cap also could prevent some interested investors from receiving a tax benefit for their contributions.

Also, since the SBT is scheduled to expire soon (at the end of 2009 under current law, or at the end of 2007 if an initiative proposal is enacted), it would make little sense to offer taxpayers an SBT credit as an incentive to support the IDA program.

Legislative Analyst: Patrick Affholter

## **FISCAL IMPACT**

The Michigan State Housing Development Authority already administers similar programs, so the cost of these additional

administrative responsibilities would be minimal.

The bills would reduce single business tax and individual income tax revenue by a maximum of \$1.0 million per year. It is unknown how many accounts would be created and how much would be saved, although during 2003, approximately 2.9 million individuals in Michigan, living in 675,000 families, resided in households with incomes of 200% of poverty or less. The amount that would be saved in the proposed accounts is also unknown, and deposits to accounts would not receive any tax preferences and would not be subject to any specific maximums. Deposits to reserve funds would be eligible for credits under the bills and also would likely qualify for a deduction from Federal taxes. (Depending on the nature of the fiduciary organizations, the deposits also could be eligible for other credits under the Michigan tax structure.)

Because the bills specify a minimum matching contribution and the credits for deposits to reserve funds would be limited to \$1.0 million per year, under the assumption that reserve fund contributors would donate only to the level to which they would receive a tax credit, approximately \$1.3 million per year would be deposited into reserve funds and would be available to match a maximum of \$1.3 million in savings by account holders annually. Deposits beyond this level could be made to the reserve funds, but would not be eligible for the proposed credits.

It is unknown how the fiscal impact of the credits would be divided between the SBT and the individual income tax, but a portion of the individual income tax impact also would be expected to reduce School Aid Fund revenue. The remaining impact would reduce General Fund revenue.

Several factors not addressed by the bills could influence participation: 1) The limited availability of matching contributions relative to the number of individuals who would potentially qualify to open an account could reduce participation; 2) the income conditions for opening an account would depend only upon income at the time the account was opened—once an individual (for example, while a student) opened an account, it would be available to him or her in perpetuity—even if the person's income (for example, after graduation) rose

substantially above 200% of poverty, and this could serve to increase participation; 3) it is unclear how fiduciary organizations and financial institutions would cover the costs of participation in the program (particularly the costs of providing financial literacy education or financial independence services, or verifying that withdrawals were for eligible purposes), which could reduce participation or the availability of the program to the eligible population; 4) verification that individuals or families did not have multiple accounts would be handled at the program site level, allowing a limited number of individuals/families to gain accounts by using multiple fiduciary organizations and reducing the number of other eligible account holders who might participate in the program; and 5) there would be no restrictions upon beneficiaries, so beneficiaries could include individuals who would not be eligible to establish an account (for example, a lower-income elderly person establishing an account for a well-off child or grandchild) as well as entities that are not natural persons (such as a business or trust), which could increase participation. To the extent that low program participation would affect the willingness of contributors to donate to reserve funds, the fiscal impact could be less than the \$1.0 million if participation were low.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.