Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 5021 (Substitute H-2 as passed by the House)
House Bill 5022 (Substitute H-1 as passed by the House)
Sponsor: Representative Kevin Green (H.B. 5021)
Representative David Robertson (H.B. 5022)
House Committee: Banking and Financial Services
Senate Committee: Banking and Financial Institutions

Date Completed: 9-6-06

CONTENT

House Bills 5021 (H-2) and 5022 (H-1) would amend the Single Business Tax (SBT) Act and the Income Tax Act, respectively, to do all of the following:

-- **Allow a qualified financial institution or taxpayer to claim an SBT credit equal to 75% of contributions made under the proposed "Individual or Family Development Account Program Act" to a fiduciary organization's reserve fund.**
-- **Allow a taxpayer who not an account holder to claim a nonrefundable income tax credit equal to 75% of contributions made under the proposed Act to a reserve fund.**
-- **Specify that the SBT and income tax credits could not exceed an annual cumulative total of $1.0 million.**

The bills are tie-barred to House Bill 5027, which would create the "Individual or Family Development Account Program Act" under which eligible individuals and families (those with a household income at or below 200% of the Federal poverty level) could establish accounts to be used for education, the first-time purchase of a primary residence, or business capitalization. The accounts would be held at financial institutions, established and managed by fiduciary organizations, and administered by nonprofit organizations known under the legislation as "program sites". Businesses and individuals could receive tax credits for 75% of contributions made to a fiduciary organization's reserve fund, which would provide supplemental funding to individual or family development accounts.

Under the proposed Act, "program site" would mean a charitable organization exempt from taxation under Section 501(c)(3) or 501(c)(14) of the Internal Revenue Code (IRC), approved by the Director of the Michigan State Housing Development Authority (MSHDA), 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, approved by the MSHDA Director or the Director's designee to manage a reserve fund. "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.

House Bill 5021 (H-2)

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 House Bill 5022 (H-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.

House Bill 5022 (H-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 House Bill 5021 (H-2) 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 (H.B. 5021)
Proposed MCL 206.272 (H.B. 5022)

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

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 House Bill 5027 specifies a maximum 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 minimum of $260,000 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. In the case of a sole proprietor or other unincorporated business, the bills would allow a taxpayer to claim a credit under both the income tax and the SBT for the same contribution.

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) the bills would allow multiple accounts to be established for any given individual, who also could be covered by a family account, and there could be multiple family accounts covering the same family; 5) the penalty provisions for unauthorized withdrawals are not substantial (for example, the penalty would not exceed the value of the tax credits for contributing to the account and there would be no procedure to require payback of any credits for deposits withdrawn for nonqualified expenses) and some aspects could be easily circumvented (such as by depleting the account on the first withdrawal so that future contributions still would be eligible for credits and/or by opening other accounts at a later time); 6) the provisions for withdrawals to cover the start-up capitalization (a term not defined in the bills) of a small business would appear to provide enough leeway that many individuals could use the withdrawals to fund many ordinary purchases; and 7) 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.

Fiscal Analyst: David Zin