

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 230 (Delegate Morales, *et al.*)
 Ways and Means

**Income Tax - Subtraction Modification - First-Time Homebuyer Savings
 Accounts**

This bill allows a taxpayer to designate an account with a financial institution as a first-time homebuyer savings account. An eligible account holder may claim a subtraction modification for (1) the amount contributed, up to \$5,000, during the taxable year to a designated account and (2) the earnings, including interest and other income on the principal, from the designated account during the tax year. The subtraction modification may be claimed for up to 10 years and for a maximum earnings amount of \$50,000 during the 10-year period.

The bill takes effect July 1, 2017, and applies to tax year 2017 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease beginning in FY 2018 due to eligible contributions and earnings being claimed against the State income tax. Based on similar programs in other states, general fund revenues may decrease by \$50,000 in FY 2018 and by \$200,000 in FY 2022. General fund expenditures increase by \$166,200 in FY 2018 due to implementation costs at the Comptroller’s Office.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	(\$50,000)	(\$75,000)	(\$125,000)	(\$150,000)	(\$200,000)
GF Expenditure	\$166,200	\$68,800	\$72,000	\$75,400	\$79,000
Net Effect	(\$216,200)	(\$143,800)	(\$197,000)	(\$225,400)	(\$279,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local revenues decrease by \$32,000 in FY 2018 and by \$126,000 in FY 2022. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill allows a taxpayer to designate an account with a financial institution as a first-time homebuyer savings account (designated account). The taxpayer may make this designation for the sole purpose of paying or reimbursing eligible costs for the purchase of a home in the State by a qualified beneficiary. A qualified beneficiary is an individual, including an account holder, who purchases a single-family home as a principal residence in the State and (1) has not owned or purchased, either individually or jointly, a home in the State in the last seven years and (2) is designated as the beneficiary of a first-time homebuyer savings account. An account holder is an individual who establishes, individually or jointly with other individuals, a designated account. Eligible costs include the down payment and eligible closing costs for the purchase of a home in the State by a qualified beneficiary.

An account holder may claim a subtraction modification for (1) the amount contributed, up to \$5,000, during the tax year to a designated account and (2) the earnings, including interest and other income on the principal, from the designated account during the tax year. The subtraction modification may be claimed for up to 10 years and for a maximum earnings amount of \$50,000 during this 10-year period.

In order to continue to qualify for the subtraction modification, the principal and earnings must remain in a designated account until the beneficiary purchases an eligible home, unless the earnings and principal are rolled over into another designated account. A person other than an account holder who transfers money into the designated account may not claim the subtraction modification. The account holder is required to use the funds in the designated account within 15 years following the date on which the account was established. At the end of the 15-year period, the remaining funds are subject to taxation as ordinary income under certain circumstances.

If the account holder withdraws any funds from the account for an ineligible purpose, the funds are taxed as ordinary income and the account holder is subject to a 10% penalty unless the account holder has filed for bankruptcy protection. A financial institution may not be held responsible for the use or application of funds deposited in or withdrawn from the account and may use funds held in the designated account for paying administrative costs.

A taxpayer claiming the subtraction modification must submit specified information to the Comptroller. The Comptroller must adopt regulations implementing the bill.

Current Law/Background: No similar State income tax subtraction modification exists.

Federal income tax law provides several benefits to promote home ownership. These include itemized deductions for eligible real estate taxes paid and qualified home mortgage interest and mortgage insurance premiums paid. According to the U.S. Joint Committee on Taxation, the mortgage interest deduction is one of the largest federal tax expenditures, decreasing federal revenues by a total of \$357 billion in federal fiscal years 2016-2020.

To pay for a house down payment, homebuyers may withdraw up to \$10,000 from a Roth Individual Retirement Account (IRA) or standard IRA if certain conditions are met. Withdrawals from a Roth IRA account are not subject to taxation. Homeowners can also withdraw money from a 401(K), subject to a 10% penalty, or borrow against the value of the account.

Numerous federal, State, and local programs provide home down payment assistance. These include federal reduced down payment loan programs through the U.S. Federal Housing Administration, U.S. Department of Veterans Affairs, and the U.S. Department of Agriculture. State programs include the Down Payment Assistance and Partner Match Programs. Local programs include Montgomery County's Moderately Priced Dwelling Unit Program.

Several jurisdictions have established similar first-time homebuyer savings account programs, including Colorado, Montana, and Virginia.

State Revenues: Subtraction modifications can be claimed beginning in tax year 2017. As a result, general fund revenues will decrease beginning in fiscal 2018. The amount of the revenue loss depends on the number of designated accounts established, the amount contributed to each account, and the eligible earnings that can be exempted from the State income tax. Contributions and earnings will generally be subject to federal taxation.

Based on the estimated amounts contributed to similar programs in other states and adjusted for differences in population and housing, general fund revenues may decrease by \$50,000 in fiscal 2018. Revenue losses will increase as additional individuals participate and deduct eligible earnings and may total \$200,000 by fiscal 2022.

State Expenditures: The Comptroller's Office advises that it will incur additional costs beginning in fiscal 2018 as a result of hiring one revenue examiner and incurring programming expenses. As a result, general fund expenditures increase by \$166,200 in fiscal 2018, which reflects a January 1, 2018 hiring date. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	1
Salary and Fringe Benefits	\$33,290
Operating Expenses	4,953
Programming Expenditures	<u>128,000</u>
Total FY 2018 Expenditures	\$166,243

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed in each taxable year. Under the assumptions above, local income tax revenues may decrease by \$32,000 in fiscal 2018, \$47,000 in fiscal 2019, \$79,000 in fiscal 2020, \$95,000 in fiscal 2021, and by \$126,000 in fiscal 2022.

Additional Information

Prior Introductions: SB 372 of 2015 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 953, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): Comptroller's Office; U.S. Joint Committee on Taxation; Department of Legislative Services

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mm/jrb

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