OLR Bill Analysis

sHB 5027 (as amended by House "A")*

AN ACT REQUIRING THE BANKING COMMISSIONER TO ESTABLISH A FIRST-TIME HOMEBUYER SAVINGS ACCOUNT PROGRAM AND ESTABLISHING A TAX DEDUCTION FOR CONTRIBUTIONS TO FIRST-TIME HOMEBUYER SAVINGS ACCOUNTS.

SUMMARY

This bill establishes an income tax deduction for certain individuals who contribute to, or who are the qualified beneficiaries of, funds deposited into a first-time homebuyer savings account, which the bill also creates. The bill requires the Department of Revenue Services (DRS) commissioner to implement the deduction, including preparing associated forms, and allows him to adopt associated regulations.

Under the bill, individuals may open savings accounts at financial institutions (i.e., banks, out-of-state banks, credit unions, or their affiliates or third-party providers) that are dedicated to paying for or reimbursing the down payment and closing costs of an account holder who is a first-time home buyer and will reside in the home purchased with account funds (i.e., the "qualified beneficiary"). The bill designates "first-time homebuyers" as those who have not previously owned or purchased, either individually or with someone else, a single-family residence.

To qualify for the bill's income tax deductions, account holders must have a federal adjusted gross income (AGI) below specified thresholds. Beginning with the 2023 tax year, the bill allows these qualifying account holders to deduct (1) the contributions deposited in the account, generally capped at $2,500 for single filers and $5,000 for joint filers; (2) any interest that accrues on the accounts; and (3) for an account holder who is also the account's qualified beneficiary, the amount withdrawn from the account that is used to pay or reimburse him or her for program eligible costs.

If funds are withdrawn from a first-time homebuyer savings account for a reason other than an allowed purpose, the bill generally imposes a civil penalty of up to 10% of the amount of withdrawn funds.

The bill requires the treasurer, by July 1, 2022, to make recommendations to the Banking Committee about if and how marketable securities may be held in a first-time homebuyer savings account (§ 3).

Lastly, the bill establishes a "Financial Literacy Trust Fund," to promote and raise awareness of financial literacy to Connecticut residents. The trust fund is a nonlapsing fund held by the treasurer separately from other moneys, funds, and accounts. It must be an instrumentality of the state and perform essential government functions. The fund must receive and hold, until used for its purpose, all payments, deposits, or contributions intended for it, such as gifts, bequests, endowments, governmental grants, and any other funds and earnings (§ 4)

*House Amendment "A" principally does the following: (1) halves the underlying bill's available deduction, from $5,000 for single filers and $10,000 for joint filers, to $2,500 and $5,000, respectively; (2) makes DRS, rather than the banking department, responsible for implementing the deduction; (3) expands the list of institutions that may hold the accounts to include more than Connecticut banks and credit unions; (4) eliminates a requirement that the commissioner prepare and distribute certain informational and promotional materials; (5) allows, rather than requires, the commissioner to adopt implementing regulations; and (6) adds the provisions on (a) marketable securities in the savings accounts and (b) the Financial Literacy Trust Fund.

EFFECTIVE DATE: January 1, 2022, for the homebuyer savings account tax deduction and upon passage for the treasurer's recommendations about marketable securities and Financial Literacy Trust Fund.

FIRST-TIME HOMEBUYER SAVINGS ACCOUNTS

Account Funds

The bill allows anyone to contribute to a first-time homebuyer savings account with no limit on the amount of contributions that may be made to, or contained in, an account. Accounts must only contain cash, but account holders may invest the funds in money market funds.

The bill limits the use of account funds to paying for (1) a qualified beneficiary's down payment and closing costs to purchase a single-family residence in the state as his or her primary residence (i.e., "eligible costs") and (2) the financial institution's account service fees. Allowable closing costs are the disbursements listed on the statement of receipts and disbursements associated with the home purchase.

Under the bill, a "single-family residence" is a single-family residential dwelling and includes a mobile manufactured home or a unit in a cooperative, common interest community, or condominium.

Account Holder Responsibilities

Establishing the Account. Under the bill, an individual may establish one or more accounts. Individuals who file a joint tax return may jointly establish and serve as account holders, but the bill requires them to jointly file tax returns for each taxable year that the account exists.

The bill prohibits an account holder from using any funds deposited into an account for administrative fees or expenses, other than the financial institution's service fees.

Designating the Beneficiary. The bill requires an account holder or joint holders to designate the account's qualified beneficiary. They must do so by April 15 of the year immediately following the taxable year during which the holder or holders established the account.

Under the bill, account holders may designate a new qualified beneficiary at any time but there may be only one qualified beneficiary associated with an account at a time. In addition, the bill prohibits

anyone from establishing or serving as an account holder of more than one account with the same qualified beneficiary.

Tax Reporting. The bill requires an account holder to submit to the DRS commissioner certain information for each tax year during which the holder has a first-time homebuyer savings account.

Specifically, the bill requires an account holder to submit his or her income tax return, along with the following information:

1. any information the commissioner requires about the account to implement the deduction;

2. the Internal Revenue Service Form 1099 issued by the financial institution for the account; and

3. if the account holder withdrew funds from the account during the taxable year, (a) a detailed accounting of the eligible and ineligible costs paid or reimbursed with account funds and (b) the remaining account balance.

Withdrawing Funds. The bill allows an account holder to withdraw any amount of the funds contributed to and deposited in an account, without penalty, as long as the funds are deposited in another first-time homebuyer savings account that the holder established.

But withdrawing from the account for a reason other than transferring the funds to another such account or paying or reimbursing the qualified beneficiary for the home purchase down payment or closing costs is generally subject to a state civil penalty of up to 10% of the withdrawn amount, which is collectable by the DRS commissioner. (The bill does not specify how or when the DRS commissioner must set or assess the withdrawal penalty. Presumably, it would be set by the DRS commissioner in regulations, but the bill only authorizes him to adopt regulations, it does not require him to do so.) If the account holder deducted these withdrawn funds for state income tax purposes (presumably as contributions to or accrued interest on the account), then they are considered income (and

presumably must be added to the account holder's AGI for the tax year in which they were withdrawn).

The bill waives the withdrawal penalty and excludes the withdrawn funds from being considered income under the following four circumstances:

1. the account holder did not claim the funds for a state income tax deduction (presumably for the deductions established under the bill),

2. the withdrawn funds were subsequently deposited in another account under the first-time homebuyer savings program,

3. the withdrawal was due to the death or disability of an account holder who established the account, or

4. the withdrawal is considered an asset disbursement as part of a bankruptcy proceeding.

Commissioner Responsibilities

As part of his responsibilities under the bill for implementing the deduction, the DRS commissioner must prepare forms for:

1. designating (a) accounts as first-time homebuyer savings accounts and (b) qualified beneficiaries and

2. account holders to submit to the commissioner information about their accounts for tax purposes and any other information the commissioner needs to perform his program duties.

The bill allows him to require financial institutions to provide certain information about each first-time homebuyer account.

Financial Institution Responsibilities

The bill limits the role of financial institutions by specifying that they are not required to:

1. designate an account as a "first-time homebuyer savings

account" or someone as the account's qualified beneficiary,

2. track the use of funds withdrawn from an account, or
3. allocate account funds among account holders.

In addition, under the bill, a financial institution is not liable or responsible for:

1. determining if, or ensuring that, an account meets the law's requirements;
2. determining if account funds are used to pay or reimburse eligible costs; and
3. disclosing or remitting taxes or penalties unless the law requires it.

However, the bill requires the distribution of funds in a first-time homebuyer savings account when a financial institution receives proof of an account holder's death and all other information required by the contract governing the account. The contract designates how the funds must be distributed.

TAX DEDUCTIONS

Beginning with the 2023 tax year, the bill establishes three tax deductions for first-time homebuyer account holders for single filers (i.e., unmarried individuals, married individuals filing separately, and heads of household) with a federal AGI of less than $162,500, and joint filers with a federal AGI of less than $275,000. The deductions are for qualifying contributions, accrued interest, and withdrawals from the first-time homebuyer accounts and apply only to the extent the income is included in the taxpayer's federal AGI.

Under the bill, the deduction for contributions generally equals the amount contributed to an account during the applicable tax year, minus any funds withdrawn during the tax year that were not already claimed for a deduction, up to a specified cap. For the 2023 tax year, account holders may deduct the amount contributed to the account for

the 2022 and 2023 tax years, up to $2,500 for single filers and $5,000 for joint filers for each such tax year (i.e., $5,000 for single filers and $10,000 for joint filers, in the aggregate). (The bill specifies that the deduction for the 2023 tax year may be claimed to the extent allowable under the federal American Rescue Plan Act of 2021.) For the 2024 tax year and thereafter, the deduction is capped at $2,500 for single filers and $5,000 for joint filers for each tax year.

The bill also allows taxpayers to deduct the interest accrued on an account during the tax year.

The bill also establishes a tax deduction for an account holder who is a qualified beneficiary in the amount of any withdrawal from an account that is used to pay or reimburse for the eligible costs he or she incurs.

COMMITTEE ACTION

Banking Committee

Joint Favorable Substitute
Yea 18 Nay 0 (02/23/2021)

Finance, Revenue and Bonding Committee

Joint Favorable
Yea 49 Nay 0 (05/03/2021)