

# First-time Home Buyer Savings Account

by Marsha A. Goetting, Ph.D., CFP®, CFCS, Professor and Extension Family Economics Specialist, Montana State University-Bozeman; Brian Olsen, Income Tax Specialist, Montana Department of Revenue

**Montana residents can save money in a special savings account for the purchase of a first home and save on Montana income taxes.**



## MontGuide

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### **MONTANA RESIDENTS CAN SAVE MONEY IN A**

special savings account for the purchase of a first home and save on Montana income taxes because of the First-time Home Buyer Act. The purpose of this MontGuide is to answer commonly asked questions about these accounts.

#### **What are some of the requirements of the new law?**

Montana residents must open a first-time home buyer savings account after Dec. 31, 1997 to qualify for a Montana income tax reduction. Montana residents who bought their first home before Jan. 1, 1998 do not qualify. If taxpayers have previously owned a home, condominium, townhouse, or modular or mobile home with a permanent foundation at any other time, in any other state or country, they do not qualify for first-time home buyer savings accounts.

The first-time home buyer savings account must be established prior to the purchase of a single-family home. You can't buy a home and then open the savings account retroactively. Money in a first-time home buyer savings account must be used for *eligible home buyer expenses* to qualify for a Montana income tax reduction.

#### **What are *eligible* first-time home buyer expenses?**

Money withdrawn from a first-time home buyer savings account is not subject to Montana income taxation if used for eligible costs for the purchase of a single-family residence by a first-time home buyer. Examples of *eligible* expenses include: *down payment, closing costs, realtor's fees, appraisal costs, credit history report, points, pro-rated property taxes and loan origination fees.*

However, if taxpayers plan to itemize such costs on their Montana income tax returns, those costs are not considered as eligible expenses. A taxpayer can't deduct such expenses twice.

#### **Where can I establish a first-time home buyer savings account?**

First-time home buyer savings accounts can be established at a state or federally chartered bank, a savings and loan, a credit union, a trust company, a mutual fund company or with a brokerage firm. The account must be kept separate from all other accounts (e.g., checking or savings accounts, IRAs, medical care savings accounts (MSAs) and so on). It must be maintained specifically for the purchase of a single-family home by the account holder.

The account holder, not the financial institution, is required to maintain documentation to verify that the withdrawals from the first-time home buyer savings account were used exclusively for eligible expenses for the purchase of a single-family home.

#### **How much can be deposited in a first-time home buyer savings account?**

A Montana resident can contribute any amount into a first-time home buyer savings account. However, the maximum amount that can be used to reduce Montana taxable income is limited to \$3,000 annually for each taxpayer who files singly, head of household, or married (filing separately).

For married couples who file their tax returns jointly, the maximum amount that can be used to reduce Montana taxable income is limited to \$6,000 annually. While married couples can have joint accounts, if they switch to separate filings in a later year, they could not make contributions to the joint account. For this reason, married couples may want to establish separate accounts.

Married couples who file separately (on the same or separate forms) must maintain separate first-time home buyer savings accounts.

Deposits to a Montana first-time home buyer saving account can be made for up to 10 years or until account holders purchase their first home, whichever comes first.

As long as the money is left in the account (or withdrawn for eligible first-time home buyer expenses), it is not included as taxable income at the state level. However, the amount deposited in a first-time home buyer account does not reduce income at the federal level.

**Example 1 (Filing Jointly):** Madeline and Walt established a first-time home buyer savings account and deposited \$6,000 in the account during the first year. On the Montana state income tax form, their gross income of \$46,000 is reduced by the \$6,000 that was deposited to the account to \$40,000 ( $\$46,000 - \$6,000 = \$40,000$ ). However, their federal income tax is computed on their gross income of \$46,000.

#### **How much will I save on state income taxes?**

One benefit of a first-time home buyer savings account is that the amount annually placed in the account (up to \$3,000 for single filers, \$6,000 for joint filers) reduces Montana taxpayers'

adjusted gross income and, as a consequence, reduces the Montana income tax that has to be paid. The amount of reduction in Montana income taxes depends on your tax bracket. If you had an adjusted gross income of \$15,400 or more in 2009, for example, you were in the 6.9 percent tax bracket.

**Example 2:** Nina reduced her Montana taxable income of \$36,500 by the \$3,000 she deposited in her first-time home buyer savings account. Because she is in a 6.9 percent Montana income tax bracket (income of \$15,400 and over), her deposit reduced the amount of Montana income tax she had to pay by approximately \$207 ( $\$3,000 \times .069 = \$207$ ). However, Nina could not reduce her federal income tax because the first-time home buyer savings account law is a state one – not federal.

### **Who may contribute to a first-time home buyer savings account?**

Montana residents who have not previously purchased a single family residence (home, condo, townhouse, or modular or mobile home on a permanent foundation) and who file income tax returns can contribute to a first-time home buyer savings account.

If a married couple buys a home in one spouse's (husband) name only and the other spouse (wife) has never been an owner of a home, then the wife would qualify as a first-time home buyer if she were to be a purchaser of a home in the future. She could open a first-time home buyer account.

If, in the case of a marriage dissolution (divorce), the name of only one spouse (husband) was on the deed and the other spouse (wife) was awarded a cash property settlement equal to half the value of the home (the deed was not changed to include the wife's name as an owner), then the wife would be eligible for a first-time home buyer savings account.

A person can give money to an eligible first-time home buyer Montana resident who could then place the money in the special account. The person who makes the gift is not entitled to the state income tax reduction. However, recipient first-time home buyer account holders can reduce their taxable income by the amount of the gift up to \$3,000 annually.

**Example 3:** Montana parents, Bruce and Barbara, want to help their two single children who are also Montana residents with future home purchases. If they give each child \$3,000 and the children deposit the money in first-time home buyer savings accounts, each child can take a \$3,000 reduction on his/her Montana income tax return. The parents, however, cannot take the reduction on their state or federal tax returns.

The annual interest earned on the accounts for each child is also exempt from taxation at the state, but not the federal level.

### **Can two non-related individuals use their first-time home buyer savings accounts to purchase a home together?**

Unrelated individuals can use their separate home buyer savings accounts to purchase a single-family home, as long as it is a first home for each purchaser.

**Example 4:** Shirley and Clay are unrelated individuals who want to buy a home together. Each is eligible for a first-time home buyer savings account. Because neither have owned a home

before, each can use his/her first-time home buyer savings account for the purchase and receive a Montana income tax reduction. They will not receive a federal income tax reduction.

### **Does prior ownership of a mobile or modular home disqualify me?**

It depends on whether the home was on a permanent foundation. A mobile, manufactured or modular home that is not on a permanent foundation and set up on a rented lot is not considered a previous home. A taxpayer in this situation qualifies as a first-time home buyer.

A mobile, manufactured or modular home that is attached to a permanent foundation, even if located on rented land, is considered as a previous home owned by the taxpayer. An individual in this situation does not qualify as a first-time home buyer.

### **What is the minimum time period a first-time home buyer savings account must be in existence before I can use it?**

First-time home buyer savings accounts must be established prior to the purchase of a qualifying home. As long as the account is opened before the closing papers are signed, the amount qualifies for the Montana state income tax reduction.

**Example 5:** Doug and Laura, a married couple, just found out about the first-time home buyer savings account from their real estate agent. They opened their account one week before closing on the home and were able to deduct \$6,000 on their Montana income tax form. Even if they opened the first-time home buyer account on the day of closing, deposited \$6,000, and then withdrew the amount for the purchase of the home, the account would qualify.

### **What is the maximum time that I can have a first-time home buyer savings account?**

The first-time home buyer account holder must use the money for eligible costs related to the purchase of a single-family residence within 10 years following the year in which the account was established.

Any principal and interest earnings in the account not used for eligible expenses when purchasing a single-family residence must be taxed as ordinary income for Montana income tax purposes in the year the home is bought if the amount had provided a reduction of income in current or prior years or if the amount was withdrawn on any other day than the last business date in December.

And, any principal or income remaining in the account on December 31 of the last year of the 10-year period must be taxed as ordinary income.

**Example 6:** Andy has contributed \$3,000 a year for 10 years in his first-time home buyer savings account. If he uses the principal (\$30,000) and interest (5 percent each year totaling \$7,733.68) as the down payment on a home, the amount is not taxed in the year withdrawn. However, if he does not use the money by the last business day in December of the tenth year after the account was opened, the full amount (\$37,733.68) is subject to Montana income taxation.

If Andy did not use the money in the account for first-time home buyer expenses there is also a 10 percent penalty (See the “*What if I withdraw the money in my first-time home buyer account for other purposes?*” section.)

### **How are interest earnings reported on my tax returns?**

Money in a first-time home buyer savings account earns interest just like money in an ordinary savings account. The interest rate paid on the account is determined by the financial institution offering it.

Interest earnings on the “deductible principal” in a first-time home buyer account are not subject to annual Montana income taxation if left in the account or if withdrawn for eligible costs for the purchase of a single-family residence by a first-time home buyer. Interest earnings must be reported on the federal return.

**Example 7:** Mary contributed \$3,000 annually for three years in her first-time home buyer savings account. The account earned an average of 5 percent interest annually during the three years (\$150 in interest the first year, \$307.50 the second year, and \$472.88 the third year). None of the interest was subject to Montana income taxation each year because the earnings remained in the first-time home buyer savings account. However, the annual interest earnings did have to be claimed on Mary’s federal income tax returns.

The earnings from a first-time home buyer savings account are reported on the financial institution’s 1099 forms that are sent to account holders and to the Internal Revenue Service (IRS). Some financial institutions send a 1099 form for each first-time home buyer savings account. Others include the first-time home buyer interest earnings in a total with other interest-bearing accounts owned by the taxpayer.

Closely examine the 1099 form so you will deduct only the appropriate amount of interest on the Montana income tax form. Interest on excess contributions to a first-time home buyers account are taxable until the excess is considered principal and deducted in future years.

### **Are there any forms that have to be filed with the Department of Revenue when I file my Montana income tax returns?**

An account holder must file an annual report form (available from the Department of Revenue) available online at [www.mt.gov/revenue](http://www.mt.gov/revenue). Click on Forms & Resources>Downloadable Forms for Current Tax Year. Then under Individual Income Tax forms, click on First-time Home Buyer Accounts.

Account holders who make a withdrawal from their first-time home buyer accounts to pay expenses for a first-time purchase of a home should keep records to verify, in case of an audit, that withdrawals were properly used to pay qualifying expenses.

### **What if I withdraw the money in my account for purposes other than first-time home buyer expenses?**

Withdrawals from an account for any purpose other than first-time home buyer expenses are subject to a 10 percent penalty (payable to the Montana Department of Revenue) unless the withdrawal falls under one of these exceptions:

*First*, a non-eligible withdrawal of funds made on the last business weekday of December is not subject to the 10 percent penalty. However, the amount withdrawn is included as ordinary income for Montana income tax purposes.

**Example 8:** On January 1 in 2008 and 2009 Donna deposited \$3,000 to her first-time home buyer savings account. On the last business weekday in December in 2009 she withdrew \$6,000 from the account for a family emergency. The withdrawal is not subject to the 10 percent penalty because she withdrew the amount on the last business day in December 2009. The \$6,000 withdrawal is subject to Montana income taxation, however.

*Second*, a withdrawal upon the death of an account holder is not subject to the 10 percent penalty. The amount withdrawn, however, is counted as taxable income at the state level for the deceased account holder for the tax year in which it was withdrawn if the amount taken out was previously a reduction of income.

*Third*, the direct transfer of funds from one first-time home buyer savings account to another first-time home buyer savings account with a different financial institution is not considered a withdrawal and, therefore, is not subject to the 10 percent penalty. In a direct transfer, the funds in the account are transferred to a first-time home buyer savings account with a different financial institution without the account holder receiving any funds.

*Fourth*, if the withdrawal is in excess of the allowable reduction, then there is no 10 percent penalty.

Account holders who make withdrawals from an account prior to the last business weekday of December that were not used to pay eligible home buyer expenses must enter the 10 percent penalty on the amount withdrawn on the Montana income tax form. The full amount withdrawn is considered as income for Montana income taxation purposes if the withdrawal amount was used to reduce income in prior years.

**Example 9:** Debbie established a first-time home buyer account in 2008 with a deposit of \$3,000. Every year for the next three years she deposited \$3,000 annually, bringing the account balance to \$12,000 in 2010. On the last business day of December in 2010 she withdrew \$5,000 for a family emergency. There is not a penalty on her \$5,000 withdrawal because she took out the money on the last business day of December. Debbie does not receive a \$3,000 income reduction in 2010 and she must report the \$2,000 withdrawn as income on her Montana return for 2010.

Individuals who make false claims about eligible first-time home buyer expenses can be penalized. For example, a person who withdraws money from an account for the purchase of a car but “claims” that the money was used for first-time home buyer expenses may be charged with theft or felony theft depending on the amount withdrawn.

### **What if I die? What happens to the money in my first-time home buyer account?**

If an account holder dies or becomes incapacitated, Montana law provides legal procedures for distributing the money in the first-time home buyer savings account. An account holder can name a payable on death (POD) beneficiary for his or her account.

If a person dies with a first-time home buyer savings account at a financial institution, then the institution is responsible for distributing the principal and accumulated interest in the account to the estate of the account holder or to a designated pay-on-death (POD) beneficiary after being furnished proof of the death of the account holder.

If the account does not have a POD designation, it is considered a part of the deceased account holder's estate. In this case, the personal representative who is appointed by the district court is responsible for notifying the financial institution of the death of the account holder. The money in the account is distributed according to the account holder's written will or Montana law if the person had no written will.

If the account holder becomes incapacitated, the funds cannot be withdrawn unless power of attorney was given to another individual or unless a conservatorship was granted to another individual.

A power of attorney is a written document in which a person gives another person legal authority to act on his or her behalf for financial transactions.

A conservatorship is a court-ordered protective relationship whereby an individual is appointed to manage another person's financial affairs after that person has become unable to do so. An attorney must file a petition with the district court and a judge decides if the person is legally competent.

## Summary

First-time home buyer savings accounts can be established at a state or federally chartered bank, savings and loan, credit union, trust company, mutual fund company, or with a brokerage firm.

The money that is placed in a first-time home buyer savings account and the annual interest earnings are not subject to state income taxation if left in the account or used for eligible costs for the purchase of a single-family residence by a first-time home buyer. However, the amounts can not be used to reduce federal income. A summary of tax effects is provided in Table 1.

The money in a first-time home buyer savings account must be used by the tenth year following the year in which the account was established.

Withdrawals for any purpose other than eligible first-time home buyer expenses are treated as ordinary income and taxed accordingly at the state level. Withdrawals are also subject to a 10 percent penalty unless the withdrawal falls under one of the exceptions mentioned earlier.



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## Acknowledgment

This MontGuide has been reviewed by representatives from:

- Montana Society of Certified Public Accountants,
- Montana Credit Union Network.

## Further information

If you have questions or need additional information regarding Montana first-time home buyer savings accounts contact:

### Montana Department of Revenue

P. O. Box 5805

Helena, MT 59604-5805

Telephone: 406-444-6900 [www.mt.gov/revenue](http://www.mt.gov/revenue)

*(The "contact us" link within the Web site may be used for your questions).*

### Montana State University Extension

Marsha A. Goetting, Ph.D., CFP®, CFCS,

Family Economics Specialist

P. O. Box 172800 Montana State University

Bozeman, MT 59717-2800

Telephone: 406-994-5695 Email: [goetting@montana.edu](mailto:goetting@montana.edu)

## Disclaimer

This MontGuide is based on Montana law in effect as of June 2008. The material presented is for information purposes only and should not be considered as tax or legal advice or be used as such. For answers to specific tax questions readers should confer with their appropriate professionals (accountants and attorneys).

**Table 1. First-time Home Buyer's Savings Account Tax Effect**

Over	Federal	Montana
Homebuyer's Contribution to Homebuyer Savings Account	No Effect	Deductible
Interest on Savings Account	Taxable	Not Taxable (Deduct on Form 2)
Withdrawals for Eligible Expenses	No Effect	No Effect
Withdrawals for Ineligible Expenses	No Effect	Taxable (Add to Form 2)
Interest on Savings Account after 10 Years	N/A (Taxed Each Year)	All Taxed
Penalty on Withdrawal	Not Deductible	Not Deductible