Tax Expenditure Evaluation:

Interest on Contributions to a First-Time Homebuyer Savings Account

STATE OF MINNESOTA
Legislative Budget Office

PREPARED FOR THE TAX EXPENDITURE REVIEW COMMISSION

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Agenda

- Background information
- Evaluation findings
- Similar findings from Colorado
- Administrative burden
- Conclusion

Background Information

- Enacted in 2017: subtraction from federal AGI for **interest on contributions** to a first-time homebuyer savings account
- Beneficiaries of the account must be Minnesota residents
- Eligible costs: purchase of a home, down payment, closing costs, cost of constructing or financing construction of a single-family residence
- On average, roughly **39 returns** claimed this subtraction in TY 2017-2024

Background Information (Contributions)

- Maximum of $14,000 for individuals and $28,000 for married joint filers may be contributed to the account each year
- Total lifetime contribution limit: $50,000 for individuals and $100,000 for married joint filers
- Maximum amount allowed in an account is $150,000
- **Important note**: subtraction is for **interest on contributions**, not amount of contributions

Background Information (Revenues)

- **Revenue Neutral Rate**: if the subtraction were repealed, the change in the income tax rate would be negligible
- Forgone revenue is less than **$50,000** per year for fiscal years 2024-2027
- Total subtraction amounts from AGI: **$249,176** for fiscal years 2017-2024
- Total tax benefit: **$19,934** for fiscal years 2017-2024

Tax Expenditure Objective

"The objective of the tax incentive for Interest on Contributions to a First-Time Homebuyer Account is to support and encourage first-time homebuyers to save for the purchase of a home."

This objective was approved and adopted by TERC on March 15, 2024.

Data Sources (2018-2024)

- Minnesota Department of Revenue
  - Number of claimants, claim amounts
  - Average income of claimants, median income of claimants
- Minnesota Realtors Association
  - Median home sales price, 20% down payment, closed sales of homes
- National Mortgage Database
  - New residential mortgage originations
  - Average loan amount, number of first-time homebuyers

Summary of Findings (2018-2024)

- On average, roughly **39 returns** claim the subtraction each year
- Only **4 claimants** end up buying a home over that time (out of 209) that were registered as a residential homestead
    - Average subtraction from AGI: **$552**
    - Average tax benefit: **$44**
    - Average loan origination amount: **$258,250**
    - Average median home sales price: **$287,344**

Similar Findings for Colorado

"The First-Time Home Buyer Savings Account Income Tax Deduction is not meeting its purpose of encouraging savings for the first-time purchase of a home because it has been used by few taxpayers and provides a small tax benefit."

Efficiency of Tax Expenditure

- Claimants must complete 3 forms:
    - Schedule M1HOME: to register savings account
    - Schedule M1M: for income additions and subtractions
    - Form M1: MN Individual Income Tax
- No administrative cost breakdown from DOR

Conclusion

- MN Legislature enacted in 2017 a subtraction from federal AGI to incentivize the first-time purchase of a home

- From 2017 to 2024, **only 4 claimants** end up buying a home (out of 209)
    - Average subtraction from AGI: **$552**
    - Average Tax Benefit : **$44**
    - Median home sales price: **$287,344**
    - Loan origination amount: **$258,250**

- Tax benefit is too small to incentivize buying a home

Potential Modifications

- At least 12 states allow subtraction for both **interests and contributions** up to maximum amount
- **Important caveat**: the LBO is not aware of any evaluations of the effectiveness and efficiency of those other structures
- Marginal tax rate for low-income taxpayers is lower than for high-income taxpayers
- Low-income taxpayers might benefit more from a refundable credit

Thank you

- Vlad Fleurimond | Economist | vlad.fleurimond@lbo.mn.gov | 651-284-6429
- Carlos Guereca | Lead Analyst | carlos.guereca@lbo.mn.gov | 651-284-6541
- Annie Lemieux | Program Evaluator | annie.lemieux@lbo.mn.gov | 651-296-6039
- Jordan Peoples | Program Evaluator | jordan.peoples@lbo.mn.gov | 651-296-6044
- Kristi Schroedl | Deputy Director | kristi.Schroedl@lbo.mn.gov | 651-284-6544
- Tax Expenditure Review Commission LBO TERC Website

General Appendix Slides

Appendix: Best Practices to Evaluate Tax Expenditures

- At minimum, evaluations should include:
  - A description of the incentive, including its history and goals
  - An assessment of the program's design and administration
  - Estimates of the expenditure's economic and fiscal impacts
  - Policy recommendations

Best Practices presented to TERC August 11, 2022, by PEW Charitable Trusts

Appendix: Best Practices… Other Criteria to Consider

- Displacement – to what extent does the expenditure benefit certain taxpayers at the expense of others?
- Leakage – does the expenditure benefit non-state residents?
- Timing – how does timing impact the level of fiscal risk and economic return to the state?
- Opportunity costs – are there trade-offs related to expenditure costs?
- “But for” – does the credit change taxpayer behavior?

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General Tax Principles

I. Allocative Efficiency (Neutrality)

II. Fairness and Equity

- Horizontal Equity – Equal treatment of equals

III. Simplicity

- Transparency
- Ease of compliance and administration

May conflict with each other or with policy goals (vertical equity, maintaining state competitiveness, promoting economic development)

Minnesota Statutes 3.8855, Subdivision 5

Tax expenditure review must include:

1. **Annual revenue lost** as a result of the expenditure
2. **Objective** of the tax expenditure
3. **Impacts and efficiency** in accomplishing its objective
4. **Compare the effectiveness** of a tax expenditure and a direct expenditure with the same objective
5. **Potential modifications** to the tax expenditure to increase efficiency or effectiveness
6. **Amount the tax rate could be reduced** if the revenue lost due to the tax expenditure were applied to a rate reduction

Minn. Stat. 3.8855, Subdivision 5 (continued)

7. **Incidence** of the tax expenditure and the effect of the expenditure on the incidence of the state's tax system (if tax expenditure is significant)
   - A significant tax expenditure, as defined in Minnesota Statutes, section 270C.11, subdivision 6, is a tax expenditure but excludes any tax expenditure that:
     a) is incorporated into state law by reference to a federal definition of income;
     b) results in a revenue reduction of less than $10,000,000 per biennium; or
     c) is a business tax credit
8. **Fiscal impacts of other state and federal taxes** providing benefits to taxpayer for similar activities
9. **Recommend** whether the tax expenditure be continued, repealed, or modified